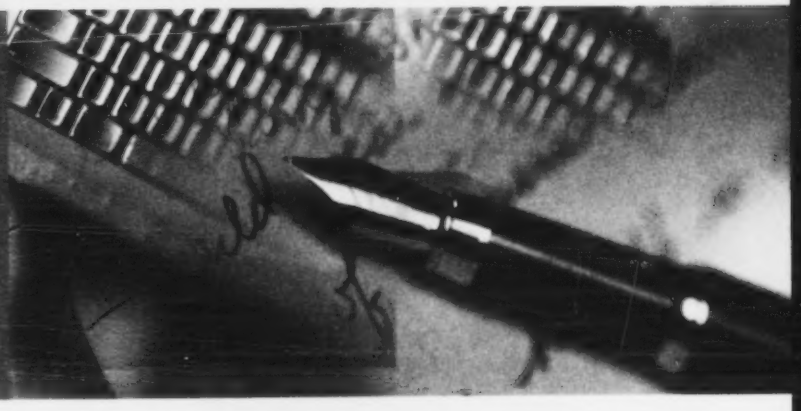
RESEARCH REPORT

CONSUMER SUPPORT AND PROTECTION IN MORTGAGE AND HOME EQUITY BASED BORROWING

EXTERNAL RESEARCH PROGRAM



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CONSUMER SUPPORT AND PROTECTION IN MORTGAGE AND HOME EQUITY BASED BORROWING:

THE U.S. EXPERIENCE AND CANADIAN COMPARISONS

FINAL REPORT

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ABSTRACT

In the U.S. in recent years, there has been a widespread perception that "predatory lending practices" have multiplied dramatically in the residential mortgage market. The report assesses whether the surge in predatory lending practices in the U.S. is an indicator of what is to come in Canada or a uniquely U.S. phenomenon - occurring because of the particular institutional, regulatory social and market framework in the U.S.

First, the U.S. experience was reviewed, including the legislation and political responses. Canadian legislation was then examined and compared with that in the U.S. Differences in the institutional and social framework that might impact the spread of predatory practices in Canada were considered. Options to protect the borrower were then explored.

A background paper drawing together the above elements, and a questionnaire soliciting views on the key issues and options was distributed to selected people in lending, regulation, credit counseling, brokerage and real estate.

Based on the analysis carried out, and drawing from the insights of the respondents, the study concluded that predatory lending is not a serious problem in Canada at the moment, but that certain factors indicate an increased risk of predatory lending in the future. The report suggests initiatives that could be undertaken now to assist borrowers in making choices, and provides a set of recommendations for implementation should future monitoring suggest that predatory lending is becoming a serious problem in Canada.

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EXECUTIVE SUMMARY

Why look at consumer protection in mortgage and home equity borrowing?

In the U.S. in recent years, there has been a widespread perception that "predatory lending practices" have multiplied dramatically in the residential mortgage market.

It is important to assess whether the surge in predatory lending practices in the U.S. is an indicator of what is to come in Canada or a uniquely U.S. phenomenon - occurring because of the particular institutional, regulatory social and market framework in the U.S.

How was the study carried out?

First, the U.S. experience was examined, including the legislation and political responses. Source material used included reports of government working groups and task forces, academic papers and reports in real estate journals, papers and reports prepared by community groups, and lenders associations, and websites of the various players.

Canadian legislation was then examined. Differences in the institutional and social framework that might impact the spread of predatory practices in Canada were considered. Options to protect the borrower were then explored.

A background paper drawing together the above elements, and a questionnaire soliciting views on the key issues and options was distributed to 43 selected people in lending, regulation, credit counseling, brokerage and real estate. Ten responses were received.

Based on the information and analysis carried out, and drawing from the insights of the respondents, a set of conclusions and suggestions were developed.

What predatory practices have been evident in the U.S.?

Predatory mortgage lending in the U.S. has been focused in the subprime market, i.e., the market for those of above average risk who cannot find a loan in the traditional market. Abuses occurring have been:

Loan Flipping: This involves repeated refinancing of a loan by a lender, with high fees and sometimes prepayment penalties each time so that the borrower's equity is "stripped".

Excessive Fees: some brokers in the subprime market have been charging up-front fees of 8 to 10% of the loan and the adding of a whole range of separate fees for specific activities, e.g., fees for document preparation, underwriting etc, or the inclusion of unwanted extras without the full understanding of the borrower.

Outright Fraud and Abuse: This can involve deceptive sales practices, and misrepresenting costs. One study reported that nearly seven in ten respondents to their survey of subprime borrowers said that they "saw key loan terms suddenly change for the worse at closing"

Lending Without Regard to the Borrower's Ability to Pay: This abuse has been blamed for high foreclosure rates in the subprime market.

Aggressive marketing: in a survey, homeowners reported that they have, in some cases for years, received weekly mailings from a lender and frequent unsolicited telephone calls urging them to set up appointments, offering free appraisals.

Other abuses included: kickbacks to mortgage brokers, falsifying loan applications, forging signatures, itemizing duplicate services and charging separately for them, requiring credit insurance with a lump sum premium paid up front, and excessive prepayment penalties.

What are the main differences between Canadian borrower protection provisions and those in the U.S.?

More streamlined legislation and enforcement: Canada does not have the proliferation of acts and regulatory bodies at the federal level which exist in the U.S. Protection for borrowers in Canada primarily resides in the acts governing the financial institutions and the accompanying "cost of borrowing" regulations. Streamlining of enforcement has been enhanced with the establishment of the Financial Consumer Agency of Canada (FCAC) in 2001. FCAC enforces the consumer-oriented provisions of the federal financial institution statutes, consolidating previous enforcement mechanisms which were different for each act.

No Special Provisions for High Cost Loans: there is no Canadian equivalent to the U.S. Home Owners Equity Protection Act (HOEPA). HOEPA provides special protection to existing owners in the *subprime* market. The prohibitions in HOEPA, e.g., against negative amortization, flipping, balloon payments etc. have no counterpart in Canada.

No Public Disclosure Requirements: Canada does not have an equivalent to the U.S. Home Mortgage Disclosure Act (HMDA) requiring lending institutions to report detailed characteristics of their lending activity and borrower characteristics for regulator and public scrutiny. This legislation was designed primarily to identify whether institutions were practicing redlining, and to identify possible discriminatory housing practices.

No Prohibition of Kickbacks, Unearned Fees, Referral Fees: The U.S. Real Estate Settlement Procedures Act (RESPA) contains prohibitions against referral fees, kickbacks and unearned fees. There are no equivalent provisions in Canada.

No Requirement to Distribute Information Booklets: RESPA requires that home buying borrowers be given a special information booklet, prepared by HUD. The U.S. Truth in Lending Act (TILA) requires the provision of a special booklet for those taking out variable rate mortgages. There is no equivalent requirement in Canada.

There is no evidence to date that indicates predatory mortgage lending practices are a problem in Canada. Similarly, it remains to be seen whether predatory lending would flourish in Canada in the future based on the following factors.

There is an increased potential for predatory lending in Canada. Major factors are:

- **Build up of home-equity-rich, income-poor homeowners**: in the U.S., predatory lending has been found mainly in the home equity loan market. The aging of baby boomers in Canada will increase the number of home-equity rich homeowners who are income-poor as result of reaching the end of their employment years. This creates an attractive pool of potential home equity borrowers, some of whom may have difficulty in obtaining loans in the traditional market.

- **Reduced employment security**: we may continue to see a higher incidence than before of home owning households being temporarily income poor after having been steadily employed. This adds to the market for home equity loans from those with uncertain prospects who could therefore be vulnerable to predatory lenders.

- **Internet loan advertising:** junk mail and internet "pop ups" provide a cheap way of reaching those who would like to access some of their home equity but have impaired credit records. Home equity loans and mortgage loans have become one of the most common junk mail offerings.

- **The profitability of the sub-prime market:** The Canadian subprime market will be attractive for U.S. lenders seeking expansion given the maturity of this market in the U.S. This increases the risk of experiencing the problems experienced in the U.S.

- **Less powerful lobby/advocacy groups than in the U.S. to ring the alarm bell:** in the U.S. powerful lobby/advocacy groups conducted a campaign to combat predatory lending. While Canada has its advocacy groups they do not have the resources of the massive U.S. groups to draw attention to the issue and lobby for action.

There are factors which will limit the growth in predatory lending in Canada. Among these are the following:

- **Minority groups may not be as vulnerable in Canada as those in the U.S.:** predatory lenders targeted minority groups in the U.S. This was the fact that drew the ire of community groups and made predatory lending a high profile political issue. Canada does not have the high incidence of economically depressed ethnic ghettos excluded from mainstream borrowing that were the feeding ground for predatory lenders in the U.S.

- **The backlash against predatory lending in the U.S. may have a sobering influence in Canada:** the backlash in the U.S. and the legislative response may serve as a warning to subprime lenders in Canada.

- **Other alternative financial services may cut into the growth in equity based "distress" borrowing:** Among the responses to the survey was the suggestion that things were evolving differently in Canada, with those in financial distress being catered to by payday loans and debt consolidators. This may to some extent cut into the home-equity based predatory lending market.

Should future monitoring suggest that predatory lending practices are becoming a problem in Canada, there are a number of things that could be done to enhance support to borrowers, particularly in the home equity loan market.

1. **Requiring the use of standardized disclosure forms:** Compulsory standardized disclosure forms should be developed in simple language, with appropriate emphasis given to the key elements of the cost of borrowing. Separate forms could be prepared for purchase mortgages and home equity loans.

2. **Educational material preparation:** CMHC, in consultation with lenders should prepare an information pamphlet related to home equity borrowing and its risks and regulations. This will complement existing material available from CMHC and lenders relating to homeownership and mortgages. Lenders associations and provincial brokers associations should be asked to encourage members to give the pamphlet referred to above to those applying for home equity loans.

3. **Monitoring:** the provinces and federal government should jointly monitor transgressions to mortgage disclosure regulations and other related regulations, and pool their data. The harmonization of the cost of credit disclosure rules which is underway facilitates this joint monitoring. This will enable regulators to keep track of whether predatory lending problems are developing.

4. **CMHC recognition of the importance of the subprime mortgage/home equity market:** The subprime mortgage market can play an important role in providing access to funding for those with impaired credit ratings. Given the growing importance of this sector of the market, CMHC should actively welcome those lenders involved in this sector, collect and publish data separately on it, and work with subprime lenders to the mutually advantageous end of ensuring that the market works well and responsibly.

5. **Development of distinct best practices guidelines for home equity/mortgage lending to those with imperfect credit ratings:** Given the uniqueness of the subprime market, its relative infancy in Canada and the likely entry of new players, the development of industry driven code of conduct/best practices guidelines in this sector would be helpful, timely and feasible. To be effective, such an initiative would be developed by Canadian subprime lenders rather than by mainstream lenders. By outlining clearly what is appropriate, and what is not acceptable, the industry would be doing a service to the borrower in this important sector and helping preclude the need for future new legislative safeguards.

6. **Imposing special rules, disclosures for high cost/high risk loans**: Should predatory lending become a significant problem in the future, it may be appropriate to consider imposing special restrictions or disclosures for higher cost loans, i.e. loans more than a certain amount (taking interest rate and fees into account) above treasury bonds. These would be separate, and over and above the provisions governing mainstream loans. The nature of the disclosures/restrictions would depend on the type of problems emerging. The advantage of focusing the special measures on "high cost" loans is there would be no extra compliance costs for mainstream activity.

RÉSUMÉ

Pourquoi faut-il examiner la protection des consommateurs en matière d'emprunt hypothécaire et de transformation de l'avoir propre foncier?

Aux États-Unis, nombreux sont ceux qui pensent que des « pratiques d'octroi de prêts abusives » se seraient fortement multipliées sur le marché hypothécaire résidentiel au cours des dernières années.

Il importe donc d'évaluer si l'émergence soudaine de pratiques d'octroi de prêts abusives aux États-Unis est un indicateur de ce qui s'en vient au Canada ou s'il s'agit d'un phénomène uniquement américain et lié à l'environnement institutionnel, réglementaire, social ou commercial aux États-Unis.

Comment l'étude a-t-elle été réalisée?

En premier lieu, la situation aux États-Unis a été examinée, y compris la législation et les réactions politiques. Les documents de base consultés comprennent les rapports des groupes de travail gouvernementaux, les rapports universitaires dans les revues spécialisées dans l'immobilier, les rapports préparés par des groupes communautaires et les associations de prêteurs ainsi que les sites Web des divers intervenants.

En second lieu, la législation canadienne a été examinée. Les différences sur le plan de l'environnement institutionnel ou social pouvant influer sur l'ampleur de pratiques abusives au Canada ont été prises en considération. Les moyens disponibles pour protéger les emprunteurs ont ensuite été étudiés.

Un document d'information réunissant les éléments susmentionnés et un questionnaire portant sur les principales questions et options ont été distribués à 43 personnes choisies des secteurs du prêt, de la réglementation, du conseil en crédit, du courtage immobilier et de l'immobilier. Dix réponses ont été reçues.

En fonction de l'information reçue et de l'analyse effectuée ainsi qu'à partir des commentaires des répondants, des conclusions et des suggestions ont été formulées.

Quelles ont été les pratiques abusives évidentes aux États-Unis?

Les pratiques d'octroi de prêts abusives aux États-Unis ont touché surtout le marché des prêts de qualité inférieure, soit le marché des emprunteurs dont le risque est supérieur à la moyenne et qui ne peuvent obtenir de prêts sur le marché conventionnel. Les pratiques abusives suivantes ont été relevées :

Refinancement à répétition – Un prêteur refinance un prêt à répétition en contrepartie, chaque fois, de frais élevés et, parfois, d'indemnités de remboursement anticipé, de sorte que l'avoir propre de l'emprunteur finit par être nul.

Frais excessifs – Certains courtiers actifs sur le marché des prêts de qualité inférieure ont exigé des frais initiaux allant de 8 % à 10 % du prêt et ont ajouté un large éventail de frais distincts pour des opérations précises, comme les frais de préparation de documents, de souscription, etc., ou ont inclus des services superflus sans l'accord clair de l'emprunteur.

Fraudes et abus manifestes – Il peut s'agir de pratiques de vente trompeuses et de coûts représentés faussement. Selon un sondage auprès d'emprunteurs moins sûrs, près de sept répondants sur dix ont déclaré que les principales modalités du prêt avaient changé soudainement et défavorablement juste avant la conclusion du contrat.

Octroi de prêts sans tenir compte de la capacité de payer des emprunteurs – Cet abus a été mentionné comme étant la cause des taux élevés de saisie sur le marché des prêts de qualité inférieure.

Commercialisation agressive – Des propriétaires-occupants ayant participé à un sondage ont déclaré qu'ils avaient reçu chaque semaine, pendant plusieurs années pour certains d'entre eux, du courrier d'un prêteur ainsi que des appels téléphoniques fréquents non sollicités les invitant à prendre un rendez-vous et à profiter d'une évaluation gratuite.

Autres abus – D'autres pratiques abusives comprennent le paiement de pots-de-vin aux courtiers hypothécaires, la falsification de demandes de prêt, l'imitation de signatures, la facturation séparée de services dupliqués, l'exigence de contracter une assurance crédit en contrepartie d'un paiement forfaitaire initial et l'imposition d'indemnités de remboursement anticipé excessives.

Quelles sont les principales différences entre les dispositions de protection des consommateurs au Canada et aux États-Unis?

Législation et application connexe simplifiées – Au Canada, le nombre de lois et d'organismes de réglementation à l'échelle fédérale n'est pas aussi élevé qu'aux États-Unis. La protection des emprunteurs fait fond essentiellement sur les lois régissant les institutions financières et les règlements connexes sur le coût d'emprunt. La simplification de l'application des lois a été améliorée à la suite de la création de l'Agence de la consommation en matière financière du Canada (ACFC) en 2001. L'ACFC fait valoir les dispositions axées sur la consommation qui sont incluses dans la législation fédérale sur les institutions financières, en consolidant les mécanismes d'obligation antérieurs qui différaient d'une loi à l'autre.

Aucune disposition particulière à l'égard des prêts à coût élevé – Il n'y a pas d'équivalent au Canada de la *Home Owners Equity Protection Act* (HOEPA) des États-Unis. La HOEPA prévoit une protection particulière à l'intention des propriétaires existants sur le marché des prêts de qualité inférieure. Les interdictions stipulées dans la HOEPA, comme l'amortissement négatif, le refinancement à répétition et les paiements libératoires, n'ont pas d'équivalent au Canada.

Aucune obligation d'informer le public – Au Canada, il n'existe pas de loi équivalente à la *Home Mortgage Disclosure Act* (HMDA) des États-Unis, qui oblige les institutions de prêt à fournir des renseignements détaillés sur leurs activités de prêt et sur les caractéristiques des emprunteurs à l'intention des organismes de réglementation et du grand public. Cette législation

a été élaborée essentiellement pour identifier les institutions imposant des restrictions géographiques et déterminer les pratiques d'octroi de prêts éventuellement discriminatoires.

Aucune interdiction des pots-de-vin, des frais non gagnés et des commissions pour recommandation – La *Real Estate Settlement Procedures Act* (RESPA) des États-Unis prévoit des interdictions concernant les pots-de-vin, les frais non gagnés et les commissions pour recommandation. Il n'y a pas de dispositions équivalentes au Canada.

Aucune obligation de distribuer des brochures d'information – La RESPA stipule que les emprunteurs doivent recevoir une brochure d'information particulière qui a été préparée par HUD. La *Truth in Lending Act* (TILA) des États-Unis prévoit qu'une brochure particulière doit être remise aux emprunteurs qui contractent un prêt hypothécaire à taux variable. Il n'y a pas d'exigences comparables au Canada.

À ce jour, rien n'indique que des pratiques d'octroi de prêts abusives constituent un problème au Canada. Sur le même thème, il reste à voir si de telles pratiques pourraient être appliquées au Canada dans l'avenir.

Toutefois, la possibilité que des pratiques abusives soient adoptées au Canada s'accroît en raison des facteurs suivants :

- **Croissance du nombre de propriétaires ayant un avoir propre foncier important mais un revenu peu élevé** – Aux États-Unis, les pratiques abusives sont courantes surtout sur le marché de la transformation de l'avoir propre foncier. En raison du vieillissement des baby boomers au Canada, le nombre de propriétaires ayant un avoir propre foncier important mais un revenu peu élevé s'accroîtra à mesure que les gens cesseront de travailler. Cela créera un bassin intéressant d'emprunteurs éventuels désirant dégager leur avoir propre foncier, dont certains auront peut-être de la difficulté à obtenir des prêts sur le marché conventionnel.

- **Réduction de la sécurité d'emploi** – En raison de la réduction de la sécurité d'emploi, le nombre de ménages propriétaires, dont les membres subissent des baisses temporaires de revenu après avoir occupé des emplois stables, pourrait s'accroître. Les prêts de transformation de l'avoir propre foncier intéresseront ceux dont la situation d'emploi est incertaine et qui sont donc plus vulnérables aux pratiques abusives.

- **Publicité sur Internet** – Les pourriels et les messages éclair sur Internet constituent une méthode peu coûteuse d'attirer l'attention d'emprunteurs moins sûrs désirant dégager leur avoir propre foncier. Les prêts de transformation de l'avoir propre foncier et les prêts hypothécaires figurent aujourd'hui parmi les produits les plus souvent offerts sur Internet.

- **Rentabilité du marché des prêts de qualité inférieure** – Le marché canadien des prêts de qualité inférieure intéressera les prêteurs américains qui veulent prendre de l'expansion puisque ce marché est parvenu à maturité aux États-Unis. Cela augmente le risque que le Canada subisse les problèmes connus aux États-Unis.

- **Influence moins grande des groupes de revendication** – Aux États-Unis, des groupes puissants ont entrepris une campagne pour lutter contre les pratiques abusives. Même si de tels groupes existent également au Canada, ils ne disposent pas d'autant de ressources que leurs homologues américains pour attirer l'attention sur le problème et exiger que des mesures soient prises à son égard.

En revanche, d'autres facteurs limiteront la croissance des pratiques abusives au Canada :

- **Les groupes minoritaires au Canada ne sont pas aussi vulnérables qu'aux États-Unis** – Aux États-Unis, les prêteurs abusifs ont ciblé les groupes minoritaires, ce qui a suscité la colère des groupes communautaires et a fait en sorte que les pratiques abusives deviennent un enjeu politique important. Au Canada, il n'y a pas autant de groupes ethniques économiquement défavorisés et exclus du marché conventionnel, qui ont été la clientèle visée par les prêteurs abusifs aux États-Unis.

- **Les réactions défavorables aux pratiques abusives aux États-Unis peuvent exercer une influence bienfaisante au Canada** – Les réactions défavorables aux États-Unis et les mesures législatives prises en conséquence peuvent servir d'avertissement aux prêteurs accordant des prêts de qualité inférieure au Canada.

- **D'autres services financiers peuvent réduire la croissance des emprunts de détresse liés à la transformation de l'avoir propre foncier** – Selon les résultats du sondage, la situation évolue différemment au Canada, et les gens éprouvant des difficultés financières peuvent obtenir des prêts sur salaire et consolider leurs dettes. Cela peut réduire le recours, dans une certaine mesure, à des pratiques abusives sur le marché de la transformation de l'avoir propre foncier.

Si l'on découvrait dans l'avenir que des pratiques d'octroi de prêts abusives soulèvent un problème au Canada, certaines mesures pourraient être prises pour mieux soutenir les emprunteurs, plus particulièrement en matière de transformation de l'avoir propre foncier.

1. **Utilisation obligatoire de formules de renseignements normalisées** – Des formules de renseignements obligatoires en langage clair devraient être préparées en mettant l'accent sur les principaux éléments du coût d'emprunt. Des formules distinctes pourraient être utilisées pour les prêts hypothécaires pour l'achat d'une habitation ainsi que pour ceux de transformation de l'avoir propre.

2. **Préparation de matériel didactique** – La SCHL, en collaboration avec les prêteurs, devrait préparer une brochure d'information sur la transformation de l'avoir propre foncier et les risques et règlements connexes, ce qui s'ajoutera à la documentation déjà offerte par la SCHL et les prêteurs au sujet de l'accession à la propriété et des prêts hypothécaires. Les associations de prêteurs et les associations provinciales de courtiers devraient encourager leurs membres à remettre la brochure susmentionnée aux propriétaires voulant obtenir des prêts de transformation de l'avoir propre foncier.

3. **Suivi** – Les gouvernements provinciaux-territoriaux et le gouvernement fédéral devraient exercer un suivi conjoint des transgressions aux obligations d'information relatives aux prêts hypothécaires et à la réglementation connexe en vue de regrouper leurs données. L'harmonisation en cours des obligations d'information relatives au coût d'emprunt facilitera un suivi conjoint, ce qui permettra aux organismes de réglementation de déterminer si des pratiques d'octroi de prêts abusives se répandent.

4. **Reconnaissance par la SCHL de l'importance du marché des prêts de qualité inférieure et du marché de la transformation de l'avoir propre foncier** – Le marché des prêts de qualité inférieure peut jouer un rôle important pour permettre aux emprunteurs moins sûrs d'obtenir du financement. Compte tenu de l'importance croissante de ce segment de marché, la SCHL devrait encourager les prêteurs concernés à s'y intéresser, recueillir et publier des données distinctes sur ce segment et collaborer avec les prêteurs accordant des prêts de qualité inférieure afin que ce marché soit exploité de manière responsable à des fins mutuellement avantageuses.

5. **Développement de directives distinctes sur les pratiques exemplaires pour le marché des prêts de transformation de l'avoir propre foncier et le marché des prêts hypothécaires à l'intention des emprunteurs moins sûrs** – Compte tenu du caractère particulier du marché des prêts de qualité inférieure, des premiers balbutiements de ce dernier au Canada et de l'entrée probable de nouveaux joueurs, le développement d'un code de conduite et de directives sur les pratiques exemplaires pour ce marché serait utile, opportun et possible. Pour être efficace, une telle initiative devrait être entreprise par les prêteurs canadiens accordant des prêts de qualité inférieure plutôt que par les prêteurs conventionnels. En définissant clairement ce qui est approprié et ce qui ne l'est pas, l'industrie pourrait rendre service aux emprunteurs concernés et contribuer à réduire le besoin d'élaborer des mesures législatives de protection dans l'avenir.

6. **Imposition de règles ou d'obligations particulières pour les prêts à coût élevé ou à haut risque** – Si des pratiques d'octroi de prêts abusives deviennent un problème important dans l'avenir, il peut s'avérer approprié de songer à imposer des restrictions ou des obligations particulières pour les prêts à coût élevé, c.-à-d. les prêts supérieurs à un montant préétabli (compte tenu des taux d'intérêt et des frais) au-dessus des obligations du Trésor. Ces dispositions seraient distinctes et s'ajouteraient à celles régissant les prêts conventionnels. La nature des obligations d'information et des restrictions dépendrait des problèmes nouveaux. L'avantage de mettre l'accent sur des mesures particulières pour les prêts à coût élevé est que cela ne créerait pas de coûts d'observation supplémentaires relativement aux activités conventionnelles.

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1. INTRODUCTION

In the U.S. in recent years, there has been a widespread perception that "predatory lending practices" have multiplied dramatically in the residential mortgage market. In response to this, a broadly based movement has developed to look after the interests of borrowers and ensure fair lending practices.

The various parties to this movement include special government committees, senators, congressmen, government agencies and regulators, a range of community groups, and class action lawyers.

It is important to assess whether the apparent surge in predatory lending practices in the U.S. is an indicator of what is to come in Canada or whether it is a uniquely U.S. phenomenon - occurring because of the particular institutional, regulatory social and market framework in the U.S.

To explore the potential vulnerability of Canadian borrowers, we need to examine what is happening in the U.S. and why. We need to assess whether similar factors causing the phenomena are present in Canada, and determine whether borrower support mechanisms, including the regulatory framework are adequate.

In Canada, there is little to compare with the various U.S. acts at the federal level dealing with mortgage lending disclosure and borrower protection. These acts themselves have all been the subject of review – with a view to tightening, in recent years. Individual states have been bringing in their own legislation, and some local governments are introducing ordinances. The internet is awash with warnings about predatory lending in the U.S., and with information on initiatives and activities in the area.

In this report, we look first at U.S. experience, including the legislation and the responses to the perceived increase in predatory lending. Following this, we briefly cover the evolution of borrower protection legislation in Canada, and recent developments here. Next we discuss the costs of inadequate consumer protection, drawing from U.S. findings, and present the other side of the coin, i.e., the potential adverse effects of consumer protection legislation. We then compare the U.S. and Canada and discuss different options to protect the borrower and help her choose wisely. After this we present the results of a small survey of selected players involved in lending, brokerage, regulation and credit counseling. Finally, we present some conclusions as to the risks in Canada, and some suggestions as to what might be done to support borrowers should predatory lending become a problem in Canada.

2. RECENT DEVELOPMENTS

2.1 PREDATORY LENDING IN THE SUBPRIME MORTGAGE MARKET

Predatory lending became a major issue after a 1998 U.S. Housing and Urban Development (HUD) study showed that borrowers in low-income, predominantly black neighborhoods were far more likely than others to pay high costs and fees for mortgages.

The spate of legislative reviews, and new acts at the federal, state and local level in the U.S. has been prompted by widespread reports of "predatory lending" practices in the rapidly expanding "subprime" market. Extensive lobbying by community and consumer groups has kept this issue alive and on the legislative agenda.

2.2 WHAT IS SUBPRIME LENDING?

The U.S. federal banking regulatory agencies describe subprime lending as follows[1]:

"Subprime lending" refers to programs that target borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, or bankruptcies. Such programs may also target borrowers with questionable repayment capacity evidenced by low credit scores or high debt-burden ratios..... Due to their higher risk, subprime loans command higher interest rates and loan fees than those offered to standard risk borrowers."

Subprime lending has expanded dramatically in the U.S. in recent years. It has brought with it a growing problem of predatory lending, i.e. lending in which the costs to the borrower are in excess of those that the higher risks would reasonably dictate

Predatory lending is a subset of subprime lending, albeit one that has cast a shadow on the whole subprime market. Legislators, lenders and others have taken pains to point out that subprime lending can and has served an important purpose in expanding access to homeownership and home improvement, and in facilitating the freeing up of equity in the home to meet owners' needs and preferences[2]. However, the subprime market is, as a HUD Treasury Task Force Report expressed it, a "fertile field" for predatory lending.

Costs to the lender *are* unquestionably higher. A KPMG Peat Marwick study found that the servicing cost for a subprime loan was more than four times the average cost for a conventional prime loan[3]

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[1] From *Guidance on Supervision of Subprime lending*, Joint press release of supervising agencies (Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision), Jan 31, 2001

[2] As indicated in 2.4, homeownership rates in the U.S. are at historical highs. It should be noted however that the HUD Treasury Task Force of 2000 (see 2.6) reported that the primary purpose of 50% of sub-prime first mortgages and 75% of sub-prime second mortgages was debt consolidation and or general consumer credit, not home purchase, home improvement, or refinancing the rates and terms of a mortgage.

[3] Reported in Real Estate Outlook, March 1999- the Changing Face of Mortgage Lending: The Subprime Market, Forrest Pafenberg.

2.3 HOW MUCH HAS SUBPRIME LENDING GROWN IN THE U.S?

The subprime market grew rapidly in the last decade of the twentieth century. Subprime mortgage originations grew from $35 billion in 1994 to $140 billion in 2000. Over the same period, subprime originations as a share of total mortgage originations grew from 5% to 13.4%. Subprime lenders accounted for about 6% of total home purchase lending, and 16% of home equity lending.[4]

2.4 WHY HAS SUBPRIME LENDING GROWN SO RAPIDLY?

There are legislative, demographic, social, economic and political reasons for the growth in subprime lending in the United States.

The first major enabling act was the 1980 Depository Institutions Deregulation and Monetary Control Act. Among the provisions of this Act was one that mandated that limitations on interest rates within state laws would not apply for loans secured by a first lien on residential property. This facilitated sub prime lending since lenders could capture the higher risk by charging higher rates.

A second boost was the Tax Reform Act of 1986. Under this act while the deductibility of consumer interest was disallowed, taxpayers were allowed to deduct interest paid on loans secured by the taxpayer's principal and one other residence. Therefore, the Tax Reform Act gave consumers an incentive to shift their consumer borrowing into home equity borrowing where the interest was tax-deductible.

The growth in subprime lending has also been supported by increasing securitization of subprime loans. This grew from $8.5 billion in 1995 to $83 billion in 1998 (somewhat lower, i.e. $60 billion in 1999).

As of 2000, about $100 billion of the $240 billion in subprime mortgage loans outstanding had been securitized (this compares with 53% of conventional prime mortgage loans that had been securitized as of 1998, the latest date for which those data were available)[5].

The aging of the population has resulted in an increase in the population of existing owners relative to those in first-time home-purchasing age. Many of these owners are sitting on substantial and growing equity in their homes while having limited incomes. The market for borrowing has thus shifted dramatically. The subprime industry has developed to tap the potential of the equity-rich, cash-poor homeowner.

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[4] Based on information from the Home Mortgage Disclosure Act returns.

[5] Source of information: Federal Reserve Bank of San Francisco Newsletter December 28, 2001, based on data from Moody's Investors Service and SMR Research Corporation

While bemoaning the fact that a disproportionate share of subprime lending goes to minority homeowners in poor neighbourhoods, the U.S. government itself, by encouraging lenders to serve poor areas and minority borrowers has contributed to the growth of subprime borrowing. As discussed later in this document, the Home Mortgage Disclosure Act (HMDA) was specifically designed to combat discrimination in lending and redlining (the singling out of whole areas as bad risks, so all applicants are denied loans regardless of their credit worthiness). The Community Reinvestment Act with its scoring of lenders on the basis of how well they serve their communities[6] reinforces this trend.

U.S. governments have set targets to increase the proportion of homeowners, particularly those previously excluded through low income. Thus, President Bill Clinton introduced the National Homeownership Strategy in 1994, with the goal of adding eight million more families by the end of the century. Targets set by the Clinton administration were in fact exceeded. The homeownership rate increased from 64.0% in 1993 to 66.8% in 1999, and peaked at a historical high of 68.1% in the third quarter of 2001[7]. More recently, in June 2002, President Bush announced a new homeownership initiative to increase the number of minority homeowners by 5.5 million before the end of this decade.

2.5 WHAT TRIGGERED THE GOVERNMENT CONCERN ABOUT THE NEED FOR CONSUMER PROTECTION?

Some of the early concern was motivated less by consumer protection concerns than by bank viability. In light of high default rates (reportedly running as high as 30% at some financial institutions), the Federal Deposit Insurance Corporation in May 1997 warned banks against the risk of too much exposure to subprime lending which could affect their stability.

However, with a HUD report in 1998 highlighting the fact that minority borrowers were disproportionately represented among those with high cost mortgages, the focus of concern shifted. Community groups took up the torch and set out to expose unscrupulous subprime lenders and force legislators to take action.

Public attention, the efforts of community groups, and the interest of the press generated a wave of anecdotal reports of homeowners - minorities, the elderly and the poor, being cheated out of their home equity by unscrupulous lenders and brokers. Lenders and politicians were quick to make the distinction between responsible subprime lending, and

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[6] Federal financial institution regulators assess the record of lending institutions in helping in seeking out loans in all parts of the community, and to low and moderate income households. As part of the examination, community and civic organizations, government, and other members of the public are invited to express their views about the institution's performance.

[7] The U.S. Census Bureau publishes quarterly estimates of the homeownership rate. Latest published data (3rd quarter 2002) show a 68.0 rate, slightly down from the 3rd quarter of 2001.

what they argued was a very small minority of lenders[8] that were engaging in predatory lending. The focus thus shifted from subprime lending as a whole, to predatory lending.

2.6 GOVERNMENT RESPONSES

Political responses were fast in coming. In 1999, the Federal Reserve Board convened a nine agency working group to strengthen the existing laws. In March 2000, a HUD/Treasury National Predatory Lending Task Force was formed. Following hearings across the country, the Task Force Report "Curbing Predatory Lending" was released. The report defined predatory lending[9]. It added to the store of anecdotal reports of predatory lending and produced recommendations for tighter legislation.

As discussed later in this document, the last few years have seen changes to the main predatory lending legislation, i.e., to the Home Owners Equity Protection Act, to widen the net, and increase disclosures and prohibitions, as well as the addition of a requirement for public disclosure of high cost loans under the Home Mortgage Disclosure Act.

The government sponsored agencies Freddie Mac and Fannie Mae have joined the campaign, refusing to purchase loans with single premium credit insurance (considered a predatory practice), and placing restrictions on prepayment provisions for eligible subprime loans and limitations on broker fees.

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[8] The claim that it was only a small number of unethical subprime lenders that are engaging in predatory lending was damaged in 2001 by a sworn affidavit from an assistant branch manager for Citifinancial Credit Company, which is a unit of Citigroup, the largest U.S. financial institution. She had a ten page list of abuses she claimed that her branch engaged in, including pressing unsophisticated high risk customers to refinance into costly new loans, and to take unnecessary coverages (source: Predatory Lending gets a closer look, News and Observer, July 6, 2001.

[9] See 3.1

3. TYPES OF PREDATORY PRACTICES

There is no shortage of lists of predatory practices. These lists have been put together by politicians, community groups, lenders associations and others. In this section we will discuss the most commonly mentioned types, and then provide a detailed listing that is often quoted by politicians and community groups. The delineation and discussion of the reported abuses in the U.S. will better enable us, later in the paper, to assess the vulnerability of Canadians to comparable predatory practices.

3.1 THE MOST COMMONLY MENTIONED ABUSES

The HUD-Treasury Joint Task Force Report "Curbing Predatory Lending" described predatory lending as follows:

"Engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of the borrower's lack of understanding about loan terms. These practices are often combined with loan terms that alone, or in combination, are abusive, or make the borrower more vulnerable to abusive practices."

The following list describes some of the main predatory practices identified by the task force and others.

3.1.1 Loan Flipping: This involves repeated refinancing of a loan by a lender, with high fees and sometimes prepayment penalties applied each time so that the borrower's equity is "stripped" from his home.

3.1.2 Excessive Fees and Packing: According to the North Carolina Department of Justice[10], some brokers in the subprime market have been charging up-front fees of 8 to 10% of the loan amount (or 8 to 10 points, using the U.S. terminology). These fees are rolled into the mortgage amount. Another source of income for the broker may be obtained through ***yield spread premiums***. This involves the broker arranging a higher than necessary interest rate for the borrower, and retaining the difference. "Packing" can involve the adding of a whole range of separate fees for specific activities, e.g., fees for document preparation, underwriting etc, or the inclusion of unwanted extras without the full understanding of the borrower.

3.1.3 Outright Fraud and Abuse: This can involve deceptive sales practices, and misrepresenting costs. The Task Force Report suggested that in many cases, predatory lenders work closely with unscrupulous brokers and home improvement contractors. The California Reinvestment Committee (CRC) in its study "Stolen Wealth: Inequities in California's Subprime Mortgage Market," released November 29, 2001 reported that nearly seven in ten respondents to their survey of subprime borrowers said that "they saw key loan terms suddenly change for the worse at closing. Eight in ten African-American

[10] North Carolina introduced its own Predatory Lending Act in 1999, which later became a model for other States.

borrowers saw key loan terms change at closing, as did over seven in ten borrowers in the study age 55 or older".

3.1.4 Single Premium Credit Insurance: A frequently mentioned "packed charge" which is generally considered as predatory practice is a lump sum (i.e. single premium) life insurance policy, which is added to the loan balance and therefore incurs interest charges as it is amortized over the life of the mortgage.

3.1.5 Lending Without Regard to the Borrower's Ability to Pay: This is another abuse which has caused concern in the U.S. and has been blamed for high foreclosure rates in the subprime market.

3.1.6 Aggressive marketing: As an example of aggressive marketing, the Consumers Union on their report on predatory lending on their website write of homeowners reporting that they have, in some cases for years, received weekly mailings from a subprime lender and frequent unsolicited telephone calls offering loans and urging them to set up appointments for free appraisals.

3.1.7 Mandatory Arbitration: The mandatory arbitration clause was singled out as a predatory practice by the joint task force. These clauses commit the borrower to go for arbitration rather than litigation in the event of a dispute. It is claimed that this places the borrower at a disadvantage because arbitration may be more costly and inconvenient for the borrower and thus a disincentive to pursuing the case.

3.1.8 Racial targeting: HUD Reported in April of 2000[11] that subprime loans accounted for 51 percent of home loan refinancings in predominantly black neighborhoods in 1998 compared to 9 percent in white neighborhoods. The percent of subprime loans in black neighbourhoods was over six times higher than in 1993 (when it was 8 percent).

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[11] *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* HUD Report April 12, 2000.

3.2 A COMPREHENSIVE LIST OF PREDATORY LENDING PRACTICES

A very comprehensive listing of predatory lending practices was presented by William J. Brennan, Jr. in his statement to the US Senate Special Committee on Aging, March 16, 1998). Brennan looks at the possible predatory acts (he lists 32) in the three stages of the loan process, i.e., marketing, the loan itself, and after closing.

William J. Brennan's Jr.'s Indicators of a Predatory Lender
Statement to the US Senate Special Committee on Aging, March 16, 1998

A. Marketing:
1. Aggressive solicitations to targeted neighborhoods
2. Home improvement scams
3. Kickbacks to mortgage brokers (Yield Spread Premiums)
4. Racial steering to high rate lenders

B. Sales:
5. Purposely structuring loans with payments the borrower can not afford
6. Falsifying loan applications (particularly income level)
7. Adding insincere co-signers
8. Making loans to mentally incapacitated homeowners
9. Forging signatures on loan documents (i.e., required disclosures)
10. Paying off lower income mortgages
11. Shifting unsecured debt into mortgages
12. Loans in excess of 100% LTV
13. Changing the loan terms at closing

C. The loan itself:
14. High annual interest rates
15. High points or padded closing costs
16. Balloon payments
17. Negative amortization
18. Inflated appraisal costs
19. Padded recording fees
20. Bogus broker fees
21. Unbundling (itemizing duplicate services and charging separately for them)
22. Required credit insurance
23. Falsely identifying loans as lines of credit or open end mortgages
24. Force placed homeowners insurance
25. Mandatory arbitration clauses

C. After closing:
26. Flipping (repeated refinancing, often after high-pressure sales)
27. Daily interest when loan payments are late
28. Abusive collection practices
29. Excessive prepayment penalties
30. Foreclosure abuses
31. Failure to report good payment on borrowers' credit reports
32. Failure to provide accurate loan balance and payoff amount

4. EXAMPLES OF PREDATORY LENDING

In this section, extracts from a number of anecdotal examples are presented, to give a clearer perspective as to what is going on in the U.S. and how politicians, community groups and the press are reacting to it. These examples are taken from a range of sources. The source is indicated after each example. It was decided not to edit the wording (except for omission of unnecessary detail), since tone and interpretation of the circumstances by those reporting them provides some insight into their thinking.

Aggressive sales practice, flipping and equity stripping

"Lucinda Ewing, a 70 year old African-American woman purchased her home in 1989 for $70,000, which included a purchase money mortgage of $30,000. Soon after, Ms. Ewing began receiving mail offers to refinance her mortgage to receive cash. Over the next few years, Ms. Ewing refinanced her home mortgage four times, with four different subprime lenders. With each refinance, she paid substantial additional loan fees and twice she paid significant broker fees. At the time of her testimony, Ms. Ewing was $5,000 behind in the mortgage payments, and she had already received an notice of intent to foreclose from the lender". *Testimony of the Assistant Secretary for Housing, William Apgar before the House Committee on Banking and Financial Services, May 24, 2000*

Fee packing and deception – loan consolidation

"All Michael Sims wanted was a $10,000 home equity loan to consolidate some bills. So the 43-year-old agreed last month to refinance the $55,000 Cleveland home he has owned for 21 years. But now he realizes he made a costly mistake: His interest rate is 13 percent instead of the 8 percent he was promised. His mortgage broker packed in thousands of dollars in hidden fees. His monthly payment is $200 more than before. And that payment doesn't even cover his taxes and insurance, which he was told would be included". (Teresa Dixon Murray, Reporter, *The Plain Dealer*, Cleveland, Ohio)

Excessively high interest rates

"These quite typical Americans didn't understand the meaning of terms like "points," "fees," "good faith estimate," "appraisal fees," and other charges before closing a deal. It was a cruel injustice when the Ransons ended up with a 15-year, fixed term mortgage at 19 percent. The Ransons could have saved $37,000 if the process had provided better access to information and real protection."
(Vento, Representative at Housing Sub-committee meeting July 22, 1998).

Ned and Victoria Wilson of Cleveland didn't know they had been gouged until last week - nearly two years after they mortgaged their paid-off house to repay bills. Ned, 75, admits he put too much trust in what a broker promised. Today, the Wilsons owe $66,000 on what started as a $40,000 loan before all of the fees and charges were added in. Their Kinsman-area home is worth only $32,100.

Ned Wilson says he never realized he was committing to paying out $753 a month. His Social Security check is only $888. (*Teresa Dixon Murray, Reporter, The Plain Dealer,* Cleveland, Ohio)

Fee packing and high broker fees stripping equity

"Roberta Green's Loan
Value of home: $81,000. Loan amount: $76,500
Payoff of existing mortgage: $53,000
Credit Insurance (not on Good Faith Estimate): $3,000
Origination fee: $7,500
Broker fee (not on Good Faith Estimate): $3,500
Paid debts: $5,690
Cash to borrower: $1,907
Equity left in house: $1,903
(Peter Skillern and Jeannette Bradley, Community Reinvestment Association of North Carolina, Reprinted from "Dollars and Sense", January/February 2000 issue

A predatory lender with a record of high fees.

"Pamela Kogurt Asst. AG of Massach said 73% of First Alliance borrowers[12] paid more than 10 points and 35% more than 20 points" *(comments at meeting Washington April 12, 2001 between Federal Reserve Board of Governers and Consumer advocates",*
("Quantifying cost of Predatory Lending" Eric Stein, Coalition for Responsible Lending)

Excessive fees, high interest rates

Through a home improvement contractor Ms. M. obtained the mortgage loan from the lender for $79,000 with monthly payments reaching approximately $970. She said she did not receive any closing documents until she contacted the lender more than a week after closing to ask for the amount of her monthly payment. The lender received 10 points, or $7,900, as well as a $695 application fee. The mortgage loan's interest rate is fixed at 14 ½%[13] with an APR of 16.498%, along with a balloon payment of $71,812.64 due 15 years after the origination date. The mortgage loan also includes a prepayment penalty if paid off during the first 12 months. Ms. M.'s loan qualifies as a HOEPA loan, but she never received any HOEPA disclosures. (From HUD-Treasury Task Force Regional Forum)

Flipping, deception, stripping of equity

Ms. H., a widowed 81 year old African-American homeowner was induced by a mortgage broker to refinance an existing $118,000 mortgage loan into a new loan for $129,000. Ms. H. testified that the broker persuaded her to take the new loan by claiming it would retire existing unsecured debt, lower her monthly payments, cover her real estate

[12] First Alliance later went bankrupt as a result of the bad publicity stemming from their business practices.
[13] Prime mortgage rates at the time were around 7%.

taxes and insurance, and lower her interest rate. None of these assertions was true. In fact, Ms. H's new loan did not pay off any unsecured debt, raised her monthly payments, did not cover her tax and insurance obligations, and, after a two year period, will significantly increase her interest rate. Not only were no unsecured debts paid off, but she received no cash out from the loan. The mortgage broker, however, made $3,850 as a result of the transaction. The same mortgage broker had originated Ms. H's prior mortgage loan, taken out in 1997.That loan contained a substantial pre-payment penalty if paid off in less than three years; thus, Ms. H. paid significant sums in the form of a prepayment penalty, in addition to her closing costs, on the 1999 refinancing. The mortgage broker's combined compensation on the two loans exceeded $12,000. (HUD-Treasury Task Force Regional Forum)

Packing with services that are not useful to the borrower

"We've had a number of clients that have been sold life insurance that requires them to be working -- when they're retired or disabled "With these insurance products, the points you get charged, the high settlement costs and whatever other junk fees you get charged, it's always financed in. ," (Nina Simon – Staff Attorney with AARP (American Association of Retired Persons).

Flipping, Equity Stripping

ABC News reported on a Charlottesville, Virginia man who went to an Associates First Capital office to get a small loan to buy groceries. He ended up being talked into 11 refinancing transactions in less than four years that resulted in a $50,000 mortgage at 19% interest that he could not afford. At this point, half the loan balance came from up-front fees (Coalition for Responsible Lending, July, 2001)

5. COST OF PREDATORY LENDING

5.1 FINANCIAL COST

The Coalition for Responsible Lending[14], in a paper released in July 2001[15] estimated the total economic cost of predatory lending to be $9.1 billion annually.

Of this total, $6.2 billion was from equity stripping, in which they included "excessive fees collected up front (such as origination or broker fees); financed fees (such as single premium credit insurance); and back-end fees (such as prepayment penalties)".

The balance of $2.9 billion was from "rate risk disparities", i.e. where borrowers were charged a higher interest rate than the risk justified.

Chart 1: Estimated Cost of Predatory Lending in the U.S.

Source	Predatory Practice	Annual Cost to mortgage borrowers ($ billion)	No. of Families Affected Annually
Equity Stripping	Financed Credit Insurance	$2.1	500,000
	Exorbitant Up-Front Fees	$1.8	750,000
	Subprime Prepayment Penalties	$2.3	850,000
Rate Risk Disparities	Excess Interest Charges	$2.9	600,000
Excessive Foreclosures	Lack Concern for Ability to Pay	No estimate	
	Total	$9.1	

Source: Quantifying the Economic Cost of Predatory Lending, Coalition for Responsible Lending, October 30, 2001

5.2 FORECLOSURES

Foreclosures are a cost of predatory lending. Aside from the personal tragedy involved, boarded-up vacant houses in areas targeted by predatory lenders can contribute to neighborhood blight and crime.

The Assistant Secretary for Housing discussed the high default rates on subprime loans when appearing before a house committee in 2000[16]. He described the rates as "the most

[14] The Coalition includes some 80 organizations with over 3 million members. Individual members include120 CEOs of financial institutions, and 200 housing, community development, consumer and religious leaders (source: Coalition website).

[15] *Quantifying the Economic Cost of Predatory Lending*, Eric Stein, Coalition for Responsible Lending, October 30, 2001

compelling evidence that subprime lending has become fertile ground for predatory practices". The main points of his testimony were:

- A study by the National Training and Information Centre found that in Chicago between 1993 and 1998, foreclosures nearly doubled, with subprime lenders accounting for a large share of this increase.

- A study by Abt Associates found that while the overall volume of foreclosures in Atlanta between 1996 and 1999 declined by 7 percent over that period, the volume of foreclosure actions initiated by subprime lenders grew by 232 percent. Abt also found that the subprime share of foreclosures is highest in lower-income and predominantly minority neighborhoods.

- Based on analyses of reports filed with the Securities and Exchange Commission, Alan M. White and Cathy Lesser Mansfield examined the default and foreclosure experience of 16 large subprime lenders. White and Mansfield estimated that for these subprime lenders, total defaults for subprime loans in the 4th Quarter of 1999 were three times as high as total defaults for all mortgages.

In summary, whether through exorbitant or unnecessary rates or charges, or through the loss of the home, the cost of predatory lending is borne overwhelmingly by those of modest income.

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[16] Testimony of the Assistant Secretary for Housing, Federal Housing Commissioner William Apgar before the House Committee on Banking and Financial Services May 24, 2000

6. UNITED STATES FEDERAL LEGISLATION

Two Acts address disclosure and consumer protection for all loans. These are:

1. **RESPA** (Real Estate Settlement Procedures Act). This deals with the disclosure settlement costs and prohibition of certain costs.

2. **TILA** (Truth in Lending Act). The provisions and prescribed formula for the Annual Percentage Rate, which must be disclosed are contained in TILA.

As we will see later, some elements of these two Acts have equivalents in the Canadian Acts governing lending institutions. There are however three other Acts which do not have equivalents in Canada. These are:

3. **HMDA** (Home Mortgage Disclosure Act). This mandates that lenders *publicly*[17] disclose details of their mortgage lending activity to enable monitoring to ensure that they are engaging in fair (no n discriminatory) lending.

4. **HOEPA** (Home Ownership and Equity Protection Act). This act mandates special disclosures and prohibitions for sub-prime (higher risk/cost) home equity and mortgage refinance loans. These provisions are to ensure that marginal borrowers are not preyed upon, and their equity whittled away by predatory lenders.

5. **HPA** (Homeowners Protection Act). This act requires notification to borrowers when private mortgage insurance is no longer required, followed by its mandatory cancellation.

These Acts are described more fully in later in this section. Charts showing the key features of RESPA, TILA, HMDA and HOEPA are presented at the end of the section.

Other relevant acts which will be referred to in this document include:

6. **AMPTA** (Alternative Mortgage Transaction Parity Act). Since state lending legislation in many cases precluded the introduction of alternative mortgage instruments (i.e. variable rate mortgages) by State chartered lenders, this act, introduced in 1982 provided parity and pre-emption from State legislation for such instruments as long as lenders followed rules applying to federally chartered lenders.

7. **ECOA** (Equal Credit Opportunity Act). This act prohibits discrimination against applicants for credit on the basis of age, race, sex, marital status, or other prohibited factors.

8. **Fair Housing Act.** The Fair Housing Act passed by Congress in 1988, prohibits discrimination in housing based on race, color, national origin, religion, sex, family status and mental or physical handicap.

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[17] see 6.4.2 for details

9. **CRA** (Community Reinvestment Act). The Community Reinvestment Act (CRA), passed in 1977 is intended to prevent redlining and encourage institutions to help meet the credit needs of the communities in which they operate including low- and moderate-income neighborhoods. Under the CRA, insured depository institution's record in helping meet the credit needs of its entire community is evaluated periodically. That performance is considered when reviewing an institution's application for deposit facilities, including mergers and acquisitions.

CHART 2. KEY LEGISLATION IN THE UNITED STATES

ACT	PURPOSE	DATE ORIG. INTRODUCED
RESPA Real Estate Settlement Procedures Act	Disclosure to borrower of *settlement costs* and prohibition of certain costs	1974
TILA Truth in Lending Act	Disclosure to borrower of *"true and total" cost of credit* (standardized calculation)	1969
HMDA Home Mortgage Disclosure Act	*Public disclosure* of mortgage lending activity to ensure fair lending meeting community needs	1975
HOEPA Home Ownership and Equity Protection Act	Enhanced disclosures, restrictions, for *sub-prime home equity* loans	1994
HPA Homeowners Protection Act	Notification when *private mortgage insurance* can be cancelled. Automatic cancel when no longer required	1999

Related Legislation

Fair Housing Act, & Equal Credit Opportunity Act..	Prohibit discrimination on grounds of race, origin, religion, sex etc
Alternative Mortgage Transaction Parity Act.....	Preempts provincial legislation for alternative mortgages
Community Reinvestment Act.....	Monitoring of institutions to ensure meeting community credit needs

6.1 TRUTH IN LENDING ACT (TILA)
(Commonly known as Regulation Z)

The Truth in Lending Act was introduced in 1969 as part of the Consumer Protection Act. It applies to all lending, not just mortgage lending. The subsequently introduced predatory lending act for high cost mortgages (HOEPA) is a special section of TILA.

TILA is intended to enable the customer to compare the cost of a credit transaction to that of a cash transaction and the difference in the cost of credit among different lenders.

The Act lays out the disclosures required for all lending, and defines the terms, i.e. the APR (annual percentage rate), Amount Financed, Finance Charge, and the Total of the Payments.. The disclosures must be given prior to the entry into the contract in writing *in a form that the borrower can keep.*

A Good Faith Estimate (GFE), based on the initial information provided by the consumer must be provided to the applicant 3 days after receiving the written application. The final disclosure statement is required at the time of loan closing.

The key amount in the calculation is the *amount financed.* In the U.S., the practice of paying up-front *points* is common. These, expressed as a percentage of the loan amount, are discount fees, or prepaid finance charges paid to write down the interest rate. These must be *netted out* of the amount financed in the calculation of the *APR* as must loan origination/commitment fees and any prepaid insurance premium.

The *finance charge* is the total amount of interest including any prepaid finance charges *and* mortgage insurance payments over the life of the loan, and the *total of payments* is this amount plus the principal payments.

If, as is normally the case, prepaid finance charges are not refundable on early repayment/termination of the mortgage, then this fact must be disclosed in the agreement.

For variable rate loans, the borrower must be provided with a special booklet "Consumer Handbook on Adjustable Rate Mortgages", published by the Federal Reserve Board and the Federal Home Loan Bank Board or a suitable substitute. Disclosures are also required in any month in which the interest rate is adjusted.

6.2 RESPA – REAL ESTATE SETTLEMENT PROCEDURES ACT

6.2.1 Background

The Real Estate Settlement Procedures Act was introduced in 1974. One of its prime purposes, through its disclosure requirements is to enable borrowers to make comparisons between products offered by different lenders. The act is also designed to reduce the cost of settlement by eliminating kickbacks and referral fees. Enforcement is by HUD.

The Act covers loans secured by a mortgage on one to four family properties. It covers most types of transactions, including purchase loans, refinancing, home equity loans and home equity lines of credit.

The Act mandates disclosures at all stages of the lending process, i.e., at the time of the loan application, at settlement, and during the duration of the loan. The required disclosures are detailed in summary chart 4.

6.2.2 The Special Information Booklet

One special feature of RESPA is the requirement that the lender and mortgage broker provide the borrower with a special information booklet. This booklet, "Buying Your Home: Settlement Costs and Useful Information" is produced by the Department of Housing and Urban Development (HUD). It is a broad ranging document of around 50 pages in length. Topics range from selecting your attorney, shopping for a loan, legal protections and disclosures, to the details of types of settlement costs and how to lodge a complaint.

6.2.3 The HUD 1 Settlement Statement

The HUD 1 Settlement Statement is a prescribed detailed form that must be provided to the borrower. It itemizes all charges for a real estate transaction. It gives each party a complete list of their incoming and outgoing funds. The borrower can request a "best estimate" version one day before closing, and a final version at closing.

6.2.4 Controlled Business Arrangements

If the settlement agent (lender, broker, etc.) refers the borrower to a firm with whom it has a business connection, i.e. ownership interest, it must declare it to the borrower.

6.2.5 Other Disclosures

An initial escrow statement showing taxes, insurance and other charges from the escrow account is required at closing or within 45 days of closing. In addition, an escrow statement must be provided to the borrower every year, and the borrower must be notified through a Servicing Transfer Statement if the servicing of the loan is transferred.

6.2.6 Prohibitions

There are three prohibitions. These are (i) taking any fee, kickback, or other thing of value in connection with "an agreement or understanding that business will be referred to any particular person" (violations can be punished with civil or criminal penalties), fee

splitting[18] and unearned fees, (ii) requiring the seller to use a particular title insurance company, and (iii) charging excessive amounts for an escrow account.[19]

6.3 HOEPA - HOME OWNERSHIP AND EQUITY PROTECTION ACT

6.3.1 Scope of HOEPA

HOEPA is *the* federal predatory lending legislation. It was introduced in 1994 to protect high risk homeowners against predatory lenders. It should be noted that HOEPA does not cover purchase loans but only borrowing by *existing* homeowners in which equity in their home is being used as security. It therefore covers refinancing and home equity loans.

If a loan meets the threshold conditions in terms of interest rate or "points" charged, then it is subject to the expanded disclosures and restrictions. As of October 2002, loans must meet the HOEPA rules if the annual percentage rate is 8% above treasury securities of equal maturity, or if the total fees and points exceed the larger of 8%of the loan, or $480. (for prime mortgages the differential relative to treasury securities has typically been around 2%). Previously, the threshold was 10% above treasuries. The tightening in the threshold is designed to further curb predatory lending by making a more loans subject to HOEPA[20].

6.3.2 Enhanced Disclosures under HOEPA

For HOEPA loans, the increased disclosures are designed to lay out very clearly what the risk is, and what the borrowers rights of recission are. The following disclosures must be provided to borrowers three business days before finalization

- A notice that the borrower has 3 days to change her mind
- A written statement that the borrower may lose their home if they do not make the required payments
- Notification of the APR and regular payment amount
- (For VRM) A statement that the payments may increase, and the maximum increase.

6.3.3 Prohibitions under HOEPA

There are a number of prohibitions that apply to HOEPA loans. These include:

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[18] For example, if the fee charged by the independent appraiser used is $150, the lender cannot bill a borrower $200 and retain the $50.00 difference.

[19] Each month the lender may require a borrower to pay into the escrow account no more than 1/12 of the total of annual disbursements, plus an amount to cover any shortage in the account. The lender may require a cushion of not more than 1/6 of the total annual disbursements. The lender must do an escrow account analysis once a year, notify borrowers of any shortage and return any excess of $50 or more.

[20] Estimates of the coverage of HOEPA differ. According to a comprehensive study carried out by Michael Staten and Gregory Ellihausen of Georgetown University , the percent of subprime loans covered by HOEPA would increase from 12% to 38% for first mortgages and 50% to 81% for second mortgages.

6.3.3.1 Extending credit without regard to a borrower's ability to pay - Firstly, to ensure that borrowers do not get in over their heads, there is a requirement that debt payments cannot exceed 50% of the borrowers income. Creditors are required to make the income check.

6.3.3.2 Loan flipping and repeated refinancing - This prohibition is designed to ensure that homeowners' equity is not stripped away by lender and broker fees. Creditors are restricted from refinancing their own HOEPA loans in the first year *when the transactions are not in the borrowers' interest.*

6.3.3.3 No prepayment penalties after 5 years – All mortgages must be open after 5 years, and there can be *no* prepayment penalties. Further the lender cannot charge prepayment penalties *in* the first 5 years where the loan is refinanced by the same lender or by an affiliated lender.

6.3.3.4 No balloon payments within the first 5 years – Except through full amortization, the loan cannot be due and payable within 5 years.

6.3.3.5 No negative amortization or "advance payments" – The balance must decline over the term of the mortgage. Advance payments, i.e., the requirement to pay more than 2 periodic payments in advance from the proceeds of the loan are also prohibited.

6.3.3.6 No direct payments to Home Improvement Contractor – To provide more protection for borrowers from collusion between unscrupulous renovation contractors and lenders, the lender cannot directly pay the home improvement contractor out of monies borrowed.

6.3.3.7 Penalties for violation

Lenders can be sued for violation of the requirements, for damages and court costs. In addition, the borrower may be able to rescind (or cancel) the loan for up to 3 years (Federal Trade Commission, Facts for Consumers, FTC website).

6.3.4 The Latest Predatory Lending Bill (Proposed Amendments to HOEPA)

The latest in a series of (until now) unsuccessful predatory lending bills "The Predatory Lending Consumer Protection Bill" is being sponsored by the Chairman of the Senate Banking, Housing and Urban Affairs Committee, Senator Paul Sarbanes a Democrat from Maryland. The main changes would be:

- A lowering of the triggers[21] in HOEPA from 8% above treasuries for first mortgages down to 6% above treasuries. An 8% trigger would apply to second mortgages.
- The total points and fees trigger would be changed from the greater of 8% of the loan amount or $480 (indexed) down to 5% of the loan amount or $1000.

[21] The "trigger" is the level of interest or fees at which the loan becomes subject to HOEPA.

- Lenders would be allowed to collect up to 2 discount points on high cost loans, but the points would have to be used to pay the rate down from a benchmark rate pegged at 5% above 5 year treasuries.
- The borrower would have to be able to recoup the dollar amount of the discount points in the form of lower payments within 4 years.
- Financing fees in excess of 3% of the loan amount or $600 would be prohibited
- No financing of fees on a loan they or an affiliate originated in the last 36 months
- Prepayment penalties limited to 3% of the loan amount
- Balloon payments not allowed
- Mandatory arbitration clauses banned
- Increase in civil penalties
- Loan buyers liable for abuses by home improvement contractors

6.4 HMDA – HOME MORTGAGE DISCLOSURE ACT

6.4.1 Background and Scope

The Home Mortgage Disclosure Act was passed in 1975. It is intended to provide the public with loan data that can be used:

a) to help determine whether financial institutions are serving the housing needs of their communities;
b) to assist public officials in distributing public sector investments so as to attract private investment to areas where it is needed; and
c) to assist in identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

Initially, the goal was just to identify the extent of "redlining", but it was expanded in 1989 to obtain information on race, income and sex, to explore discrimination at the individual level.

The scope has expanded again with a requirement that from January 2004 (start recently delayed from January 2003), lenders will be required to identify high cost loans.

The act requires financial institutions to collect data on applications for, originations of, and purchases of home purchase loans, home improvement loans and refinancings. The information must be recorded on a register within 30 days after the quarter in which the event took place. They must be submitted to the supervising agency office[22] agency office by March 1 following the calendar year to which they relate on the forms provided by the Federal Financial Institutions Examination Council (FFIEC).

[22] FDIC, FRS, HUD or NCUA depending on the institution.

6.4.2 Data collected under HMDA

a) A number for the loan or loan application, and the date the application was received.
b) The type and purpose of the loan.
c) The owner-occupancy status of the property to which the loan relates.
d) The amount of the loan or application.
e) The type of action taken, and the date (accepted, rejected, withdrawn etc.)
f) The location of the property to which the loan relates, by MSA, state, county, and census tract, if the institution has a home or a branch office in that MSA.
g) *The race or national origin and sex of the applicant or borrower, and the gross annual income relied upon in processing the application.*
h) The type of entity purchasing a loan that the institution originates or purchases and then sells within the same calendar year.
i) (As of January 2004) lenders must identify first mortgages with interest rates 3% above comparable treasuries, and second mortgages with rates 5% above treasuries.

6.4.3 Public Reports Prepared from HMDA Data

Aggregate reports, and reports down to the municipal statistical area level are prepared by the Federal Financial Institutions Examination Council (FFIEC). Individual lenders must make the information on their own lending (the mortgage loan disclosure statement which is prepared by FFIEC based on their own reporting) available for inspection and copy at one of their branches in the area, and post a notice at the other branches indicating where it is available.

FFIEC aggregate reports and disclosure reports for each metropolitan statistical area (MSA) are available to the public at central data depositories located in each MSA, and on the FFIEC website.

To illustrate the depth of information readily available from the HMDA data, a table covering loan applications for refinancing of loans in Orange County California is included (see chart 7).

The individual supervising agencies may produce their own reports in more user friendly formats with charts, commentary and analysis.

6.4.4 Follow Up on HMDA Data

The Federal Reserve Board performs statistical analysis of denial rate patterns by large lenders. Regression analysis is used to determine whether race, national origin etc. is a significant predictor of the credit decision. If this appears to be the case, then follow-up will take place. If this follow-up does not provide a satisfactory explanation, the case is referred to the Justice Department for further investigation.

6.4.4 Is HMDA Useful?

A study in 1996[23] suggested that HMDA data on their own are not adequate to draw meaningful conclusions about discrimination, since key underwriting factors (credit history, debts, employment etc. are correlated with race. Because of this, it is not possible to determine whether minorities are turned down more often because of discrimination, or because they are less creditworthy.

6.5 THE HOMEOWNER'S PROTECTION ACT (HPA)

6.5.1 Background

The Homeowner's Protection Act was introduced in 1998. It is designed to protect homeowners from continuing to pay private mortgage insurance (PMI) premiums when they are no longer necessary.

It is estimated that lenders require 40% of new homeowners to purchase private mortgage insurance[24]. Lenders usually require PMI where borrowers put in less than 20% equity. Private mortgage insurance typically covers the top 20% of the original loan amount, and is paid for by monthly premiums that range between $50 and $150 per month.

The act was a response to criticisms from consumer groups that many homeowners were continuing to pay the monthly insurance premiums even though the equity in the property had reached 20%. Given a 95% loan and a 8% interest rate, this point is reached at around the 13th year of the mortgage.

In the words of the Federal Reserve Board of San Francisco (from their website):

In the past, most lenders honored consumers' requests to drop PMI coverage if their loan balance was paid down to 80 percent of the property value and they had a good payment history. However, consumers were responsible for requesting cancellation and many consumers were not aware of this possibility. Consumers had to keep track of their loan balance to know if they had enough equity and they had to request that the lender discontinue requiring PMI coverage. In many cases, people failed to make this request even after they became eligible, and they paid unnecessary premiums ranging from $250 to $1,200 per year for several years. With the new law, both consumers and lenders share responsibility for how long PMI coverage is required.

6.5.2 Specific Provisions:

a) Borrowers can request cancellation of PMI when:

- Mortgage balance is scheduled to reach 80% of the original property value

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[23] Stanley Longhofer, Federal Reserve Bank of Cleveland *"Discrimination in Mortgage Lending: What Have We Learned", August 15, 1996*

[24] Estimate from Brian R Witt, Credit Union Magazine, May, 1999

- payment history is good (never been 30 or more days late in last 12 months, or 60 or more days late in last 24 months).
- The property value of the home has not declined.

b) Lenders must automatically cancel private mortgage insurance when the loan balance reaches 78% of the original property value.

It should be noted that public mortgage insurance (FHA insurance) is not covered under the legislation, however, there are built-in provisions of FHA insurance that provide for reimbursement of monthly premiums and the unused proportion of the up-front premium[25].

6.5.3 Costs/benefits of the legislation

The sponsor of the Bill argued that around $195 million of overpayments were made each year by borrowers who had built up more than 20% equity in the property. This is around 7% of total annual PMI premium revenue. The $195 million estimate has since been questioned as not fully taking into account loans paid off early, which if allowed for, would reduce estimate of homeowner savings to roughly $105 million[26] per year.

According to Congressional Budget Office cost estimates, the cost of implementation of the bill was $55 million in the first year, ($5 million to governments and $50 million to lenders) and $35 million thereafter.

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[25] Under FHA insurance there is an upfront mortgage insurance premium of 1.50%. If the loan is terminated during the first 5 years, a proportion of the upfront premium may be refunded (the mortgage holder must apply for this refund). There is also a monthly fee (0.5% of the loan amount on an annual basis). The monthly mortgage insurance payment will automatically be cancelled when the outstanding principal balance reaches 78% of the original purchase price.

[26] *The Homeowners Protection Act: Protection for Whom and at What Cost?*, Dawn R. De Tienne and Elaine Worzala, Real Estate Finance Journal, Spring 1999

Summary Charts:

CHART 3. TILA – THE TRUTH IN LENDING ACT

DISCLOSURES

ALL MORTGAGES

- ANNUAL PERCENTAGE RATE
- AMOUNT FINANCED (Loan less prepaid charges)
- FINANCE CHARGE (COST OVER TERM IN DOLLARS)
- AMOUNT AND TIMING OF PAYMENTS
- MUST DISCLOSE IF PREPAID FINANCE CHARGES (E.G. MORTGAGE WRITE DOWNS ARE NOT REFUNDABLE IF LOAN IS PAID OFF EARLY

SPECIAL REQUIREMENTS FOR ADJUSTABLE RATE MORTGAGES* (ARMs):

MUST MAKE GOVT. BOOKLET "CONSUMER HANDBOOK ON ADJUSTABLE RATE MORTGAGES" OR SIMILAR ONE AVAILABLE TO BORROWERS DISCLOSURES MUST BE MADE EACH TIME AN INTEREST RATE CHANGE OCCURS.

*Note: This disclosure applies to any loan secured by the consumer's principal residence in which the annual percentage rate may increase after consummation and the term of the loan exceeds one year. This would include the Canadian rollover mortgage.

PROTECTION

3 DAY RIGHT OF RECISSION – can cancel the loan within 3 business days of signing the loan documents.

Summary Charts:
CHART 4: RESPA – REAL ESTATE SETTLEMENT PROCEDURES ACT

RESPA, the Real Estate Settlement Procedures Act was introduced in 1974. Its purpose is to protect mortgage borrowers by requiring disclosure of costs and prohibition of certain costs.

DISCLOSURES BEFORE SETTLEMENT

SPECIAL HUD INFORMATION BOOKLET
Purchase transactions only. Contains information on settlement costs

CONTROLLED BUSINESS ARRANGEMENTS
Where referral is made to a provider with whom an ownership or other beneficial interest exists

HUD-1 SETTLEMENT STATEMENT (BEST ESTIMATE)
Shows all charges. Borrower can request to see it one day before settlement (to be based on information known at the time

DISCLOSURES AT SETTLEMENT

HUD-1 SETTLEMENT STATEMENT (ACTUAL COSTS)
To be provided at settlement. If not the practice for borrower and seller to attend, should be mailed as soon as practicable afterwards.

INITIAL ESCROW STATEMENT
Taxes, insurance etc. to be paid from escrow account in first 12 months., and required cushion. Usually given at settlement, but lender has 45 days.

DISCLOSURES AFTER SETTLEMENT

ANNUAL ESCROW STATEMENT
Escrow payments during last year, shortfalls, surpluses, action taken.

SERVICING TRANSFER STATEMENT
Notify 15 days prior if servicer selling or assigning servicing rights

PROHIBITIONS

KICKBACKS, FEE SPLITTING, UNEARNED FEES
No fee, kickback etc. to anyone for referral of settlement service business
Criminal case: $10,000 or 1 year jail. Civil case: 3 times insurance cost

SELLER REQUIRING USE OF SPECIFIC TITLE INSURER
Seller cannot as condition of sale require buyer uses specific title insurer
Buyer can sue for 3 times amount charged

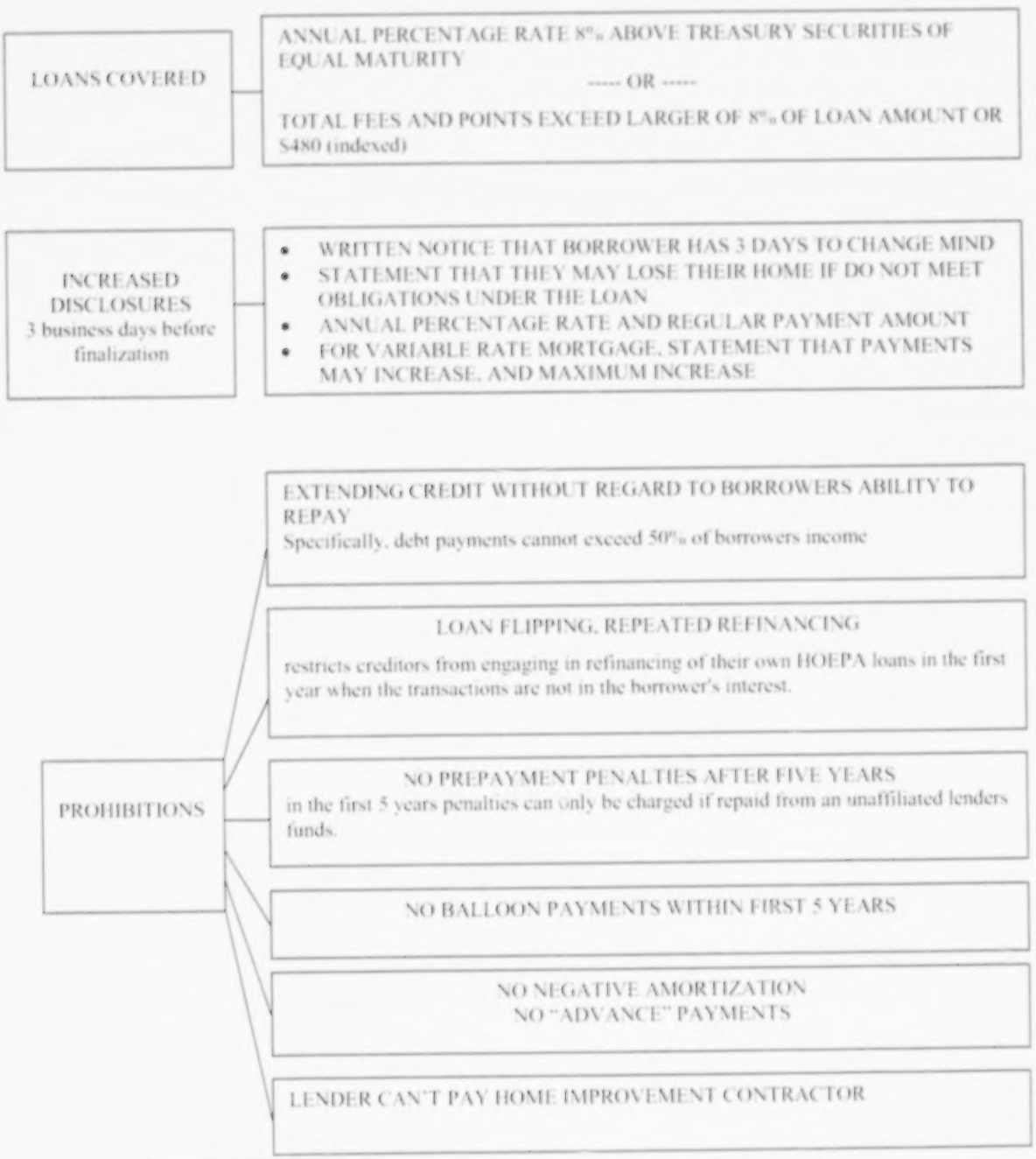
EXCESSIVE ESCROW ACCOUNTS
Limits are $1/12^{th}$ per month with $1/6^{th}$ cushion plus amount for shortfall
Yearly analysis and return of amounts in excess of $50 required

Summary Charts:

CHART 5. HOEPA - HOME OWNERSHIP AND EQUITY PROTECTION ACT[27]

(Regulation Z)

Introduced 1994 to protect high risk homeowners against predatory lenders. Covers mortgage refinance & home equity loans. ***not purchase loans or construction loans, lines of credit or reverse mortgages.***


LOANS COVERED
ANNUAL PERCENTAGE RATE 8% ABOVE TREASURY SECURITIES OF EQUAL MATURITY
----- OR -----
TOTAL FEES AND POINTS EXCEED LARGER OF 8% OF LOAN AMOUNT OR $480 (indexed)
INCREASED DISCLOSURES
3 business days before finalization
WRITTEN NOTICE THAT BORROWER HAS 3 DAYS TO CHANGE MIND
STATEMENT THAT THEY MAY LOSE THEIR HOME IF DO NOT MEET OBLIGATIONS UNDER THE LOAN
ANNUAL PERCENTAGE RATE AND REGULAR PAYMENT AMOUNT
FOR VARIABLE RATE MORTGAGE, STATEMENT THAT PAYMENTS MAY INCREASE, AND MAXIMUM INCREASE
PROHIBITIONS
EXTENDING CREDIT WITHOUT REGARD TO BORROWERS ABILITY TO REPAY
Specifically, debt payments cannot exceed 50% of borrowers income
LOAN FLIPPING, REPEATED REFINANCING
restricts creditors from engaging in refinancing of their own HOEPA loans in the first year when the transactions are not in the borrower's interest.
NO PREPAYMENT PENALTIES AFTER FIVE YEARS
in the first 5 years penalties can only be charged if repaid from an unaffiliated lenders funds.
NO BALLOON PAYMENTS WITHIN FIRST 5 YEARS
NO NEGATIVE AMORTIZATION
NO "ADVANCE" PAYMENTS
LENDER CAN'T PAY HOME IMPROVEMENT CONTRACTOR

[27] with amendments effective Oct 2002

Summary Charts:

CHART 6. HMDA – HOME MORTGAGE DISCLOSURE ACT

The purpose of the Act is to see whether lenders are engaging in fair lending practices, and in the best interests of communities and are not practicing discrimination.

INFORMATION TO BE DISCLOSED	TYPE OF LOAN AMOUNT ACTION TAKEN (granted, refused, application withdrawn) RACE, NATIONAL ORIGIN, SEX LOCATION (Municipal statistical area, county, census tract)
NEW REQUIREMENTS	From Jan 1, 2003: LENDERS MUST ASK ETHNICITY, SEX AND RACE FOR TELEPHONE APPLICANTS From Jan 1, 2004: MUST RECORD INTEREST RATE SPREAD ON FIRST MORTGAGES 3% ABOVE COMPARABLE TREASURY SECURITIES, AND SECOND MORTGAGES 5% ABOVE.
PUBLIC EXPOSURE	Federal Financial Institutions Examination Council (FFIEC) creates aggregate reports, and for each metropolitan statistical area – available on website. HMDA data are available to the public in the form of disclosure statements at the home office of individual lending institutions and at a central depository within each MSA Individual lenders must make their report available within 3 days of receiving it from the Council

CHART 7. SAMPLE TABLE FROM HMDA REPORT

ORANGE COUNTY, CA. AGGREGATE TABLE 4-3: DISPOSITION OF APPLICATIONS TO REFINANCE LOANS ON 1 TO 4 FAMILY HOMES, BY RACE, GENDER AND INCOME OF APPLICANT, 2000

Race, Gender & Income	Apps. Received	Loans Originated	Approved But Not Accepted	Apps. Denied	Apps. Withdrawn	Files Closed as Incomplete
AM. INDIAN/ALASK. NAT. (TOTAL)	223	118	23	37	24	21
MALE	64	39	4	10	5	6
FEMALE	61	29	6	12	7	7
JOINT (MALE/FEMALE) [1]	97	50	13	15	12	7
ASIAN PACIFIC ISLANDER (TOTAL)	4029	2074	390	943	374	248
MALE	983	444	103	260	97	79
FEMALE	837	415	82	201	94	45
JOINT (MALE/FEMALE) [1]	2198	1210	204	478	183	123
BLACK (TOTAL)	700	272	60	205	88	75
MALE	192	74	10	60	29	19
FEMALE	187	73	22	58	19	15
JOINT (MALE/FEMALE) [1]	319	125	28	85	40	41
HISPANIC (TOTAL)	6499	2663	540	1765	775	756
MALE	1757	616	145	518	219	259
FEMALE	1115	485	82	271	146	131
JOINT (MALE/FEMALE) [1]	3604	1558	313	965	404	364
WHITE (TOTAL)	28144	15778	2550	5370	2707	1739
MALE	7178	3575	712	1543	801	547
FEMALE	5550	3060	519	1074	536	361
JOINT (MALE/FEMALE) [1]	15358	9112	1312	2740	1367	827
OTHER (TOTAL)	912	404	89	230	153	36
MALE	315	114	26	97	66	12
FEMALE	161	85	14	44	11	7
JOINT (MALE/FEMALE) [1]	423	202	44	86	75	16
JOINT (WHITE/MINORITY) [2] (TOTAL)	1435	852	121	264	125	73
MALE	45	22	4	8	10	1
FEMALE	25	17	2	4	2	0
JOINT (MALE/FEMALE) [1]	1364	813	115	251	113	72
RACE NOT AVAILABLE [3] (TOTAL)	17946	5517	1868	6042	3814	705
MALE	1158	460	122	366	157	53
FEMALE	810	345	79	256	105	25
JOINT (MALE/FEMALE) [1]	2455	1184	232	649	293	97
INCOME OF APPLICANTS [4]						
LESS THAN 50% OF MSA MEDIAN	3621	1156	276	1192	604	393
50-79% OF MSA MEDIAN	9574	4045	865	2625	1259	780
80-99% OF MSA MEDIAN	7503	3514	732	1867	873	517
100-119% OF MSA MEDIAN	7133	3457	731	1706	816	423
120% OR MORE OF MSA MEDIAN	26113	14010	2633	5510	2638	1322

Source: Federal Financial Institutions Examination Council's (FFIEC) Website

7. PRESENT INITIATIVES AND ISSUES IN THE U.S.

As indicated, there is a great deal of activity in the U.S. in response to the predatory lending concerns. This section describes some of the more significant initiatives.

7.1 HOEPA amendments (incorporated in charts and description in section 6)

Amendments to HOEPA announced Dec 12, 01, effective Oct 1, 02:

--lowered the trigger at which first lien loan must meet HOEPA requirements from 10% above treasuries to 8% above treasuries
--broadened the fee based trigger by including credit insurance premiums and debt cancellation fees
--prohibit certain acts and practices to prevent "loan flipping"
--require creditors to verify and document consumers' repayment ability
--require the HOEPA disclosures to include the total amount borrowed and whether that amount includes the cost of optional credit insurance

7.2 HMDA Changes (incorporated in the description and charts in section 6)

Under the new HMDA requirements, lenders will be required to report the interest rate spread on first mortgages that exceed comparable Treasury securities by 3 percent. The reporting threshold for second mortgages would be 5% above Treasury securities. According to FRB, the 3% threshold would cover 98 percent of sub-prime first mortgage loans, and that most prime first mortgages would be exempted, as well as 98 per cent of subordinated loans with the subordinated loan threshold at 5%.

In addition, lenders will be required to ask for ethnicity, sex and race of telephone applicants. This will enable a clearer measure of comparative approval/denial rates for whites and minorities.

On May 5, 2002, the FRB postponed the implementation of the new reporting rule (except the requirement to obtain race and gender information on telephone applications) to January 1, 2004, to give lenders time to change their reporting systems.

7.3 Allowing for Bundling of Services (RESPA relaxation)

HUD is proposing a new rule under RESPA to enable the provision of "guaranteed packages and the bundling of settlement services and mortgage loans. The intent is to enable a broader choice for borrowers. Presently RESPA rules have prohibited this.

7.4 Class Actions Suits Regarding Yield Spread Premiums (RESPA)

The morality and legality of yield spread premiums has been an active issue in the last few years. The National Association of Mortgage Brokers (NAMB) on the debate on the HUD Treasury Task Force reported that there had been 150 class action suits alleging

that a payment of a yield spread premium is a violation of RESPA. HUD has recently issued a "clarification" to the effect that yield spread premiums are not *per se* a violation of RESPA if a service is being provided and the spread is reasonable for it. This will render it difficult for lawyers to go the class action route.

7.5 AMPTA: Proposals to Exempt Prepayments, or Repeal the Act

The Office of Thrifts Supervision (OTS) has recommended that Congress consider repealing the Alternative Mortgage Transactions Parity Act (AMPTA) since all states but one now allow alternative mortgage instruments. States are prevented from enforcing tighter rules than those applying to federally chartered institutions, thus impeding their flexibility to implement and enforce their own predatory lending acts.

When the act was introduced, states had 3 years to opt out of federal preemption. Only a few states did.

On March 24, 2002, the OTS announced a proposal to exempt prepayments rules from the applicable regulations under AMPTA.

The lending industry is saying that the proposal to repeal the act or to remove the prepayments rules from the applicable rules could place state chartered lenders at a disadvantage in states with stricter predatory lending laws. By contrast a total of 44 states, and 150 community organizations[28] are reported as supporting the proposal to remove the prepayment rules from the provisions that can be preempted.

7.6 Actions by FNMA, Freddie Mac and FHLB in Support of Prepayment Penalty Restrictions

Freddie Mac and Fannie Mae, the government sponsored mortgage secondary market operators and securitizers have both recently announced their intention to no longer invest in subprime mortgages with prepayment penalty terms that exceed three years.

7.7 NAMB Proposed Model Mortgage Broker Licensing Bill

The National Association of Mortgage Brokers (NAMB) is pushing a model bill to tighten up on licensing requirements for mortgage brokers and retail loan officers. They put this approach forward as an alternative to the introduction of tighter predatory lending legislation. Under the NAMB Bill, to obtain a license, the broker would have to:

(i) pass a criminal background check (including finger prints)
(ii) prove that they have managed the affairs of clients with care and diligence
(iii) have completed a relevant course of study

According to Joe Falk, past president of NAMB, only 16 states have laws for brokers and lenders, and only 8 mandate broker education as a licensing requirement.[29]

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[28] Source of statistics: DallasNews.com subprime lending archives.
[29] Inside B&C Lending, July 1, 2002

7.8 HUD Credit Watch Termination Initiative

HUD announced on August 9, 2002 that it would be strengthening its enforcement of its *credit watch* on lenders.

The HUD Credit Watch was introduced in May 1999. Under its provisions, HUD can bar lenders from making FHA loans if their default and claim rates in the last 24 months in a geographical area are 200% of the average rate for that area and if their rate exceeds the national default and claim rate.

Since launching Credit Watch, HUD has terminated lending approval for 120 branches and placed an additional 219 branches on warning status. This has been based on HUD's focus on lenders whose rates are 300% of the local average. By July 2003, HUD will have gradually lowered the barrier on its enforcement down to the lower limit of 200% of the average local rate.

7.9 HUD Appraiser Watch Initiative

The *Appraiser Watch Initiative* was announced on July 18, 2002. This initiative is designed to hold appraisers accountable for their performance. The standards will apply to the estimated 25,000 individuals who conduct appraisals on Federal Housing Administration-insured single-family homes.

According to the HUD press release, the appraisal will "protect unsuspecting victims, who are often first-time homebuyers and minorities, from poor appraisals and unscrupulous appraisers." Under the proposal, FHA will monitor appraisers' default and claim rates and will apply sanctions - including removal from its list of approved appraisers - against those whose rates are excessive.

FHA will notify appraisers before removing them from its roster of approved appraisers. Any appraiser who receives such notice may meet with HUD officials to present evidence that factors beyond his or her control contributed to the excessive rates.

7.10 Phasing out of Single Premium Credit Insurance (Life Insurance)

Single Premium Credit Insurance came under attack in the HUD Treasury Task Force Report as a predatory practice[30]. More recently the Federal Trade Commission came out strongly against it arguing that "that the nature of the transaction does not permit free and informed consumer choice, that disclosure alone would not cure the violative practice, and that only restrictions on the practice itself would be sufficient".

In response to the widespread criticism of the practice, all major subprime lenders had discontinued offering single premium credit insurance by mid 2001.

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[30] see 3.1.4

The Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation recently announced that they will no longer purchase single premium credit insured loans.

7.11 Mandatory Arbitration

The Federal Trade Commission (FTC) has recommended to Congress that mandatory arbitration clauses should be prohibited in high cost loans, i.e. loans that meet the HOEPA cut-offs. The Commission has argued that "arbitration may be more costly and inconvenient for the borrower and thus be a disincentive to pursuing legal rights"[31] The recommendation echoes that of the HUD Treasury Task Force Report on Predatory Lending.

[31] Prepared presentation of the Federal Trade Commission to the Federal Reserve Board on September 7, 2000

8. STATE LEGISLATION, AND LOCAL ORDINANCES

8.1 State Legislation

The trailblazing act at the state level in the U.S. was North Carolina's predatory lending law. This was passed in 1999. Like HOEPA, this act cuts in at specific rate and fee triggers. The details of the legislation are summarized in chart 8.

The National Community Reinvestment Coalition (NCRC) Anti Predatory Lending Toolkit[32] contains details on federal and state bills and local ordinances relating to predatory lending. NCRC claim that the listing is comprehensive. Details are provided on predatory lending bills introduced in 33 states during 2001-2. *Inside B&C Lending* reported on June 17, 2002 that 16 States have now enacted legislation aimed at predatory lending in the last 2 years.

Some of the state bills are based on the North Carolina Bill. Others are based on models put forward by consumer groups. The prohibitions all relate to the predatory practices prohibited in HOEPA or outlined elsewhere in this report.

One State act that has run into problems has been the Georgia Fair Lending Act (GFTA) of October 1, 2002. Under the GFTA, borrowers who have been exploited could obtain damages not only against the original lenders, but all parties involved in the mortgage-market chain. This includes underwriters of securities backed by the pools of home loans. A consequence was that the three major bond rating agencies refused to rate Mortgage Backed Securities which included loans covered by the Act. This could have had very serious consequences for the supply of mortgage credit. As a result, in February 2003, the Georgia Senate unanimously voted for changes to the law. Following these changes, one of the bond raters has already announced (March 14, 2003) that it will rate loans originated after the changes.

8.2 Local Ordinances

At the local level, NCRC shows ordinances being introduced in 12 counties or municipalities. These are mostly similar to the state and federal legislation.

In an effort to curb predatory practices, a few local ordinances prohibit the city or local government from dealing with lenders that engage in predatory practices. Thus, Chicago's predatory lending ordinance mandates that an institution wishing to hold city funds must submit a pledge affirming that neither it nor an affiliate is or will become a predatory lender. Institutions determined by Chicago chief financial officer or city comptroller to be predatory lenders are prohibited from being designated as a depository for city funds and from being awarded city contracts.

Pennsylvania and Ohio which have their own predatory lending legislation have overturned local ordinances in Philadelphia, Pittsburgh, Dayton).

[32] See 9.3 for details

CHART 8. NORTH CAROLINA'S PREDATORY LENDING STATUTE

LOANS COVERED

Similar to HOEPA (October 2002 triggers):

INTEREST RATE 8 % ABOVE TREASURIES

In excess of HOEPA:

- WHERE PREPAYMENT PENALTY IN EXCESS OF 2%
- WHERE BORROWER AGREES TO PREPAYMENT PENALTY IF LOAN PREPAID AFTER 30 MONTHS

PROHIBITED

Similar to HOEPA:

BALLOON PAYMENTS, FLIPPING, LENDING WITHOUT REGARD TO BORROWER'S ABILITY TO PAY, NEGATIVE AMORTIZATION ETC.

In excess of HOEPA:

- PREPAYMENT PENALTIES ON LOANS FOR $150,000 OR LESS
- LENDING WITHOUT HOMEOWNERSHIP COUNSELING
- FINANCING OF FEES AND CHARGES, INCLUDING 3rd PARTY FEES
- FEES NOT EXPRESSLY AUTHORIZED BY LAW MAY NOT EXCEED .25% of PRINCIPAL AMOUNT OR $150

9. ENFORCEMENT

Enforcement of the Truth in Lending Act (TILA), including the Home Ownership and Equity Protection Act (HOEPA), as well as the Equal Credit Opportunity Act is by the Federal Trade Commission (FTC).

As of March, 2002, FTC had brought15 enforcement actions against subprime lenders allegedly engaged in unlawful practices in the past 3 years.

In a January 2002 press release, HUD announced that its fraud prevention initiative in Baltimore had in the last eight months resulted in over 40 indictments, 27 prosecutions, and 66 disbarments of individuals and Corporations involved in predatory lending.

9.1 Legal actions by the Federal Trade Commission

Examples of the actions of the Federal Trade Commission (FTC) involve:

On March 21, 2002, FTC announced a settlement with First Alliance Mortgage Company (now bankrupt) under which nearly 18,000 borrowers could receive as much as $60 million. First Alliance allegedly charged 10-25% in fees, misled customers about increases in interest rates and monthly payments on ARMs and did not provide the ARM[33] booklet required by the Truth-in Lending Act[34].

In July, 1999, under the "Operation Home Inequity" initiative, FTC settled cases against 7 lenders involving HOEPA and TILA violations. These involved consumer redress totaling $572,000 and one lender being banned from offering high cost mortgage loans.

A settlement with Fleet Finance, in 1999 for $1.3 million in consumer redress as well as injunctive relief for failing to provide active and timely disclosure.

A settlement with Delta Funding Corporation on March 30, 2000, providing for nationwide injunctive relief. The main focus of the case was Deltas practice of "asset based" lending, i.e. lending without regard to the borrower's ability to pay.

In July, 1982, Mercantile Mortgage Company, agreed to settle charges by FTC that they deceived borrowers about the terms of their loan. The proposed settlement will require the company to make a $250,000 payment for consumer redress and create a program to offer refinanced loans on favorable terms to certain borrowers with balloon loans[35].

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[33] The booklet is required for all loans secured by the consumer's principal residence for which the term is greater than one year and for which the interest rate may increase during the term (see summary chart 3).
[34] Details of First Alliance Case from Mortgage Daily.com (Sam Garcia). Details on other settlements from "Prepared Statements of the Federal Trade Commission".
[35] Source: FTC press release July 18, 2002

10. INVOLVEMENT BY COMMUNITY AND ADVOCACY GROUPS

10.1 The role played by of Community and Advocacy Groups

A feature of the U.S. environment has been the active and intense involvement of many community and advocacy. These have played a role in:

- lobbying politicians
- drafting model legislation
- making the public aware of predatory lending
- public campaigns against specific large predatory lenders
- spearheading legal action

Groups have operated at the national, state and local levels. Among the most active groups have been AARP (American Association of Retired Persons), ACORN (Association of Community Organizations for Reform Now), and NCRA (National Community Reinvestment Coalition).

10.2 AARP (American Association of Retired Persons)

AARP (the American Association of Retired Persons) is a "nonprofit membership organization dedicated to addressing the needs and interests of persons 50 and older". Fortune magazine in its Fortune 25 Power Ranking ranked AARP as the most powerful political lobby group in the U.S. ,until 2001, when it dropped to second place (after the National Rifle Association). AARP has a budget of half a billion dollars.

AARP entered the predatory lending arena in 1998 by suing First Alliance Mortgage Company (see section 9.1) on behalf of homeowners who had been the victims of First Alliance's predatory practices. AARP's claims were consolidated with the claims brought by the Federal Trade Commission (FTC), class action suits, and actions by a number of states. AARP alleged in its suit that First Alliance's engaged in manipulative and fraudulent sales practices, skimming 15-20 percent of the value from their homes.

In 2001, AARP launched a campaign in 25 states to fight predatory lending. The campaign involves advocacy and consumer education.

10.3 ACORN (Association of Community Organizations for Reform Now)

ACORN which claims to be "the nation's largest community organization of low and moderate-income families, with over 120,000 member families organized into 600 neighborhood chapters in 45 cities across the country"[36] has been very active in fighting predatory lending.

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[36] Self description from website at acorn.org

ACORN has carried out a very public campaign against against two major subprime lenders, Household and Beneficial, and the parent company, Household International aimed at obtaining restitution for victims, and forcing them to drop predatory practices.

ACORN's campaign has included:

- Demonstrating at the company's shareholder meetings
- Working with city councils to support divestment from Household
- Direct actions targeting Household's offices around the country
- Neighborhood outreach to warn people about Household loans
- A media strategy with in print, radio, and TV coverage
- Complaints to state bank regulators and attorneys general in more than 10 States

Acorn also contributed to the predatory lending debate though its publication, *The Great Divide* which used HMDA data to analyze racial and economic disparities in home purchase mortgage in sixty metropolitan areas.

10.4 NCRC (National Community Reinvestment Coalition)

The National Community Reinvestment Coalition has produced a 200 page *Anti Predatory Lending Toolkit*. The kit presents details of all anti-predatory bills and acts at the federal, state and local level.

The coalition also presents its own model predatory lending bill "for use and reference at the federal, state and local level". The model bill tightens restrictions for all home loans, incorporating restrictions on flipping and single premium credit insurance, while retaining (consistent with HOEPA) a stricter set of rules for high cost loans (defined as 4% above treasuries).

10.5 Other active interest groups

The National League of Cities, the U.S. Conference of Mayors, the Consumers Union, the Consumers Federation of America are all active in lobbying at the federal level. As an example, over 20 consumer and community groups are lobbying the FRB not to change its schedule for collecting loan price data under HMDA, and 150 community groups are supporting the latest predatory lending bill.

11. ADVERSE CONSEQUENCES OF PREDATORY LENDING LAWS: THE VIEW FROM THE U.S.

The protection given to consumers by the various laws and regulations must be set against any adverse effects of the legislation.

These can include:

1. reduction of access to funding for marginal borrowers;
2. regulatory burden including costs;
3. possible impediments to providing the most cost-effective deal to borrowers;
4. distortions in the market through unequal burden of regulations on different institutions;
5. frivolous lawsuits; and
6. potential for misunderstanding/misinterpretation of public disclosure data.

The goal is to achieve an appropriate balance where consumers have adequate protection, but lenders are not overburdened by regulation, and lending to marginal borrowers is not choked off.

The adverse consequences of the various acts and regulations have been detailed by mortgage lenders and others in the U.S.

11.1 Reduction of access to funding for marginal borrowers

Treasury Assistant Secretary Sheila Baird, talking at the National Association of Mortgage Brokers' legislative conference on April 15, 2002 stressed that it was important that efforts to combat predatory lending should not damage the expansion of the availability of credit in the subprime market. She said that "responsible providers of subprime credit provide an important source of credit to borrowers with damaged credit histories (which) …will not easily be replaced by government programs or through the activities of other lending institutions. [37]

Officials of the Mortgage Bankers Association of America are suggesting that the proliferation of legislation at the state level has affected the subprime market, and that the impending requirement to disclose high cost loans under HMDA will have further impacts on the availability of subprime financing. Compounding the impact on the subprime market will be the lowering of the triggers on HOEPA which will make a higher percentage of subprime loans subject to the increased disclosures and restrictions under the act[38].

North Carolina being first off the ground with a state predatory lending law which has been more restrictive than HOEPA[39] can potentially provide some insight as to legislative

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[37] Real Estate Finance Today, April 22, 2002.
[38] See 6.3.1
[39] HOEPA's trigger moves down to 8% above treasuries in October 2002, in line with North Carolina's.

impacts. Inside B&C Lending, June 29, 2002 reports that based on data from four large securitizers, North Carolina's subprime volume dropped by 27.4% in 2001 and 2002, compared to 1999 and 2000. This compares to a national decline of close to 11%[40]. However, there were other states with no predatory lending initiatives which showed higher than average declines, so Inside B&C Lending is hesitant to conclude that the act is behind the decline.

11.2 Impediments to providing the most cost-effective deal

Restrictions on lending practices can limit choice. Thus, restrictions on prepayment penalties and balloon payments will logically result in borrowers paying more in interest charges to offset the lesser prepayment fees. The restrictions prevent lenders from tailoring a package to meet borrowers' preferences and needs and can increase costs to borrowers that would settle for less "protection" where they feel they do not need it.

HUD officials have themselves acknowledged the criticism that prohibitions in RESPA may "make lenders and others unwilling to engage in activities to negotiate a package of settlement services and that this ultimately deprives the consumer of lower settlement costs"[41] As discussed earlier they have recently proposed a new rule under RESPA to address this.

11.3 Regulatory burden and cost

The cost of implementing borrower protection laws has been a focus of the arguments against the initiatives. For example, the Congressional Budget Office in April 1997 estimated that the first year cost to the 18,000 private lenders in the U.S. of implementing the Homeowners Protection Act of 1998 would be $50 million and $30 million in subsequent years[42]. This is $2,777 per lender in the first year and $1,666 in subsequent years.

11.4 Distortions through the unequal burden of regulations

Regulatory burden typically falls more heavily on smaller institutions. A study prepared for the Independent Banker's Association[43] suggested that banks with under $30 million in assets had almost four times the compliance costs per dollar of assets than those over $65 million in assets. This can "create a marginal incentive to consolidate the industry into larger market participants.

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[40] Inferred by me from decline in North Carolina share of total from 2.8% to 2.3% as provided in article.
[41] Laster, General Counsel of HUD at Housing Subcommittee session July 22, 1998
[42] Information from *The Homeowner's Protection Act: Protection for Whom and at What Cost*, by Dawn R. DeTienne & Elaine Worzala, Real Estate Journal Spring 1999.
[43] *Regulatory Burden, The Cost to Community Banks*, a study prepared for the Independent Bankers Association of America by Grant Thornton in January of 1993

11.5 Frivolous Lawsuits

There have been over 150 class action suits alleging that payment of a yield spread premium constitutes a violation of the RESPA provisions. The issue is whether yield spread premiums are legitimate payments for services, or unlawful payments of referral fees. The situation necessitated a "clarification" by HUD in October 2001. The ruling clarifies that yield spread premiums are not unlawful per se if they reflect reasonable compensation for services provided. By subjecting the legality of a yield spread premium to the particulars of each, HUD has made it difficult for lawyers to take the class action route against lenders.

11.6 Misinterpretation of public disclosure data

Given the difficulty of determining whether unbiased risk characteristics, or discrimination are at core of differential rejection rates for loans by race, the Home Mortgage Disclosure Act has come in for its share of criticism, as providing fodder for those with an agenda.

12. CANADIAN LEGISLATION

12.1 THE CANADIAN FEDERAL LEGISLATIVE FRAMEWORK

The Canadian legislative framework at the federal level is considerably simpler than that in the U.S. The elements are the *Interest Act* and the separate acts governing the different *federally chartered* financial institutions, i.e., *the Bank Act, The Trust and Loan Companies Act and the Insurance Companies Act of Canada.*

In addition, the *Criminal Code*, defines a criminal rate of interest (60% per annum or more)

12.2 THE INTEREST ACT

The Interest Act was passed in 1880. The provisions of the act as it relates to mortgages are:

- If the mortgage does not contain a statement showing the principal and the rate of interest chargeable, calculated yearly or half yearly, not in advance, then no interest whatever shall be charged.

- No fines or penalties are allowed on arrears. The interest rate on arrears cannot exceed the interest rate on the mortgage as disclosed.

- All mortgages are repayable after 5 years, with a maximum penalty of 3 months of interest.

In its original form, the bill contained a provision setting a maximum interest rate. This was dropped between the second and third readings of the bill owing to strong opposition from those who argued that the public interest was best served by a free market[44].

12.3 PREVIOUS ATTEMPTS TO CHANGE THE INTEREST ACT

Since its introduction in 1880, there have been two abandoned government efforts to change the interest act. These are:

- The Borrowers and Depositors Protection Bill of 1976
- The Bill to Amend the Interest Act in 1984

12.3.1 The 1976 Borrowers and Depositors Protection Bill

The Borrowers and Depositors Protection Bill was a comprehensive bill designed to:

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[44] For an interesting account of the background and politics surrounding the bill, see *Section 10 of the Interest Act: All the King's Men*, Mary Anne Waldront, Canadian Business Law Journal, Vol 13, 1987-8

- Protect Borrowers against unwarranted interest rates and loan sharking
- Provide improved information to borrowers and depositors through expanded and better defined disclosures
- Eliminate complexities and confusion
- Provide a standard minimum level of protection across the country.

It's comprehensiveness led to its downfall, since there was something to upset everyone, i.e. lenders, consumer groups and the provinces (who argued that many provisions of the bill were unconstitutional since they ventured into areas of provincial jurisdiction.

A potentially extremely powerful anti-predatory lending provision under the bill, which would have applied to all credit transactions including mortgages, was the introduction of the concept of *Unwarranted Credit Charge Rate*. Under the provision, the borrower could take the lender to court on the grounds that the level of credit charge was unwarranted, and demand renegotiation and reimbursement of unwarranted excess charges. The onus was on the lender to prove that the credit charge was justifiable on the grounds of the interest rate prevailing at the time, the cost of funds, and the risk that the borrower represented.

There were special provisions relating to mortgages. For *fixed rate* mortgages, these would have brought the prepayment privileges for all homeownership loans in line with those under the National Housing Act, i.e. for a term of more than 3 years, the prepayment rules would allow:

- Up to 10% prepayment on the first and second anniversary of the mortgage
- Full repayment on or after the third anniversary on any payment date
- A maximum penalty for these prepayments of 3 months interest.

For *variable rate* mortgages, which were a new unregulated innovation on the market at the time, a "strong set of protective measures"[45] was incorporated. It should be noted that the typical variable rate mortgages on the market today would not be permitted under the proposed restrictions. The restrictions included:

- The rate to be charged was to be specified as a fixed number of percentage points above the rate on non-checkable savings accounts
- The interest rate could not be changed more frequently than at the anniversary of the loan
- Prepayment could be made on any payment date.
- The maximum prepayment penalty was 3 months interest in the first year. There was no prepayment penalty allowed after the first year.

[45] As phrased in the "Backgrounder" prepared by Consumer and Corporate Affairs at the time.

12.3.2 The 1984 Act to Amend the Interest Act

The main rationale for the 1984 Bill to amend the interest rate was complaints from homeowners who were stuck with high mortgages rates[46] when interest rates declined, and were unable to refinance, or were upset at the penalties lenders were demanding.

The Bill would have required disclosure of prepayment privileges up-front, and disclosure, not only of the interest rate and principal, but of other charges related to interest, e.g. administration charges.

The meat of the Bill however was in the repayment provisions. The Bill would have allowed prepayment of a mortgage at any time. The maximum prepayment penalty would have been the difference between the interest that the lender would have earned if the mortgage ran to maturity less the interest that would be earned at the lower prevailing rate - discounted to present value.

The penalty cost that this involved was clearly not what discontented homeowners holding high interest rate mortgages had in mind. The bill received a rough ride in the house, and died on the order paper.

12.4 THE FINANCIAL INSTITUTION ACTS

The acts governing federally chartered financial institutions are:

- Bank Act
- Trust and Loan Company Act
- Insurance Companies Act of Canada

These acts contain common consumer protection provisions relating to (a) disclosures of the cost of borrowing, (b) complaint procedures, (c) prepayment privileges, (d) prohibitions against tied selling.

The provisions have been refined as part of the 2001 Bank Act revision process. The wording of the provisions reflect the recommendations flowing from the Federal Provincial initiative to harmonize consumer credit legislation and is finding its way into provincial and territorial statutes (see section 13).

Chart 10 summarizes these provisions as written into the act and prescribed in the respective regulations.

[46] 5 year mortgage interest rates rose as high as 21% in 1981. By 1984 they were below 12%.

12.4.1 Disclosures

Cost of Borrowing: The Acts requires disclosure of the cost of borrowing. The Regulations prescribe what is to be included in the cost of borrowing, and show how the APR is to be calculated.

As in the U.S., the cost of borrowing includes the interest on the loan and all other non-voluntary fees and costs that the borrower is billed by the lender in securing the loan. This includes administrative costs, legal costs paid to any lawyer that the lender requires the borrower to retain, broker fees if included in the amount borrowed and paid directly by the bank to the broker. Insurance, appraisal and inspection costs are only included if paid directly by the lender (and billed to the borrower). High ratio mortgage default insurance is not included.

Prepayment Privileges: The institution must specify borrower's rights to repay and any charges/penalties.

Timing: The initial disclosure statement must be provided to the borrower on or before the earlier of the making of a payment (other than a disbursement charge[47]) in relation to the agreement by the borrower and two clear business days before the entering into the credit agreement.

Cancellation of optional services: It must be clearly disclosed that optional services (e.g. insurance) that are paid for on an ongoing basis can be cancelled at the request of the borrower.

Variable Interest Rate Mortgages: There are detailed disclosure requirements relating to variable rate loans, both at the time of agreement and during the course of the loan. These mandate disclosure of the rules determining variation in payments, and the notifications of changes in interest rate and payments.

12.4.2 Complaint Procedures

The Acts require that institutions establish complaint procedures, specifically, they must

- designate an officer to implement procedures, and one or more to receive and deal with complaints
- file a copy of the procedure with the Commissioner of the Financial Consumer Agency of Canada
- tell customers with complaints how they can contact the Agency

[47] "disbursement charge" can include charges to register documents, appraisal and inspection charges, title insurance, and high ratio insurance charges.

The Commissioner prepares a report on complaints received and how they were dealt with (i.e. complaints that have exhausted the institutions' procedures and have been referred to the Commissioner).

12.4.3 Prohibition against tied selling

As in the legislation in the U.S. , the institution cannot exercise pressure to place life insurance for the loan with a specific company, although it can require that a company chosen by a borrower meet with its approval, which "cannot be unreasonably held".

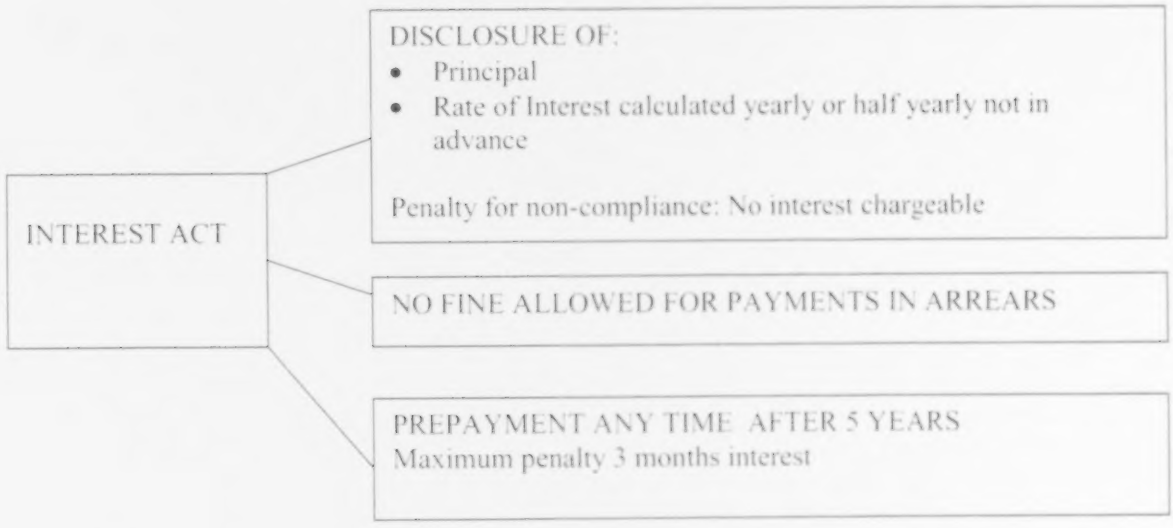
Institution cannot impose undue pressure on, or coerce a person to obtain a product or service from itself, an affiliate or specific person as a condition of obtaining a loan. But it can offer more favorable terms on condition a product or service is purchased.

12.5 The Usury provisions of the Criminal Code

The Criminal Code, section 347 specifies a criminal interest rate of interest of 60% per annum. Anyone who enters into an agreement to receive interest at the criminal rate is liable to imprisonment for a term not exceeding five years, "or a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both".

The provision was enacted in 1981 to combat loan sharking.

CHART 9. CANADIAN FEDERAL LEGISLATION


INTEREST ACT
DISCLOSURE OF:
• Principal
• Rate of Interest calculated yearly or half yearly not in advance
Penalty for non-compliance: No interest chargeable
NO FINE ALLOWED FOR PAYMENTS IN ARREARS
PREPAYMENT ANY TIME AFTER 5 YEARS
Maximum penalty 3 months interest

FINANCIAL INSTITUTION ACTS

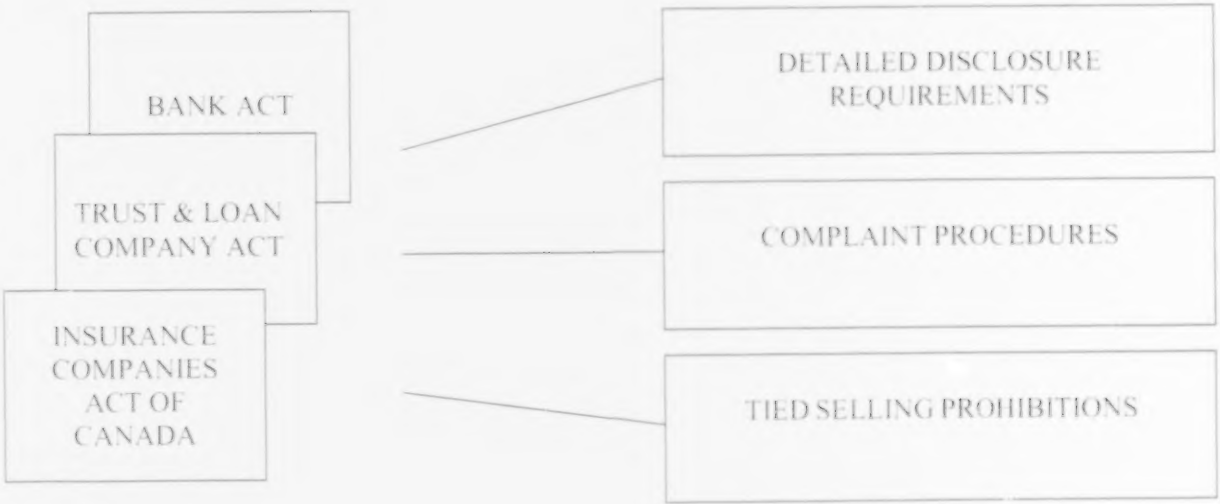


CHART 10. CANADIAN FEDERAL LEGISLATION: THE FINANCIAL INSTITUTIONS ACTS

DISCLOSURE REGULATIONS RELATING TO MORTGAGES

Disclosure content	Principal, amount, timing of advance Total amount of all payments Cost of borrowing in dollars	Annual interest rate, compounding APR Term, amortization period
VRM additional disclosure content	Additional requirements include: • method for determining interest rate • fact that negative amortization is possible • special notifications during course of loan	
Best Estimate	Information in disclosure statement may be based on estimate if cannot be known, and identified as such.	
Clarity	Clear, draw attention to information required to be disclosed.	
Medium	Can be electronic if borrower consents in writing.	
Timing- Initial disclosure	Earlier of (i) making a payment (other than a disbursement) or (ii) 2 business days before making agreement, or (iii) by consent.	
Renewals	Disclosure date 21 days before renewal (same timing to notify of non-renewal). No change in interest rate before renewal.	
Waiving payments	If offer to waive payment, must make it clear that interest continues accruing.	
Optional Services	Must state that they can be cancelled. Pro-rata formula to be used.	
Default Charges	Must specify. (Can include: legal to collect; cost of realizing on security; processing check)	
Advertising	Include APR prominently if quoting interest rate. Representative loan. Where waiving payment, indicate if interest accrues, and APR, condition for waiving, APR when condition not met.	
Backdating	Regulations apply to renewal or ongoing administration of existing agreements.	

Source: Consolidated Statutes and Regulations, Department of Justice

13. PROVINCIAL LEGISLATION: FEDERAL PROVINCIAL HARMONIZATION

Typically, provincial consumer credit legislation has resided in a range of acts depending on the province. All provinces have had some form of consumer protection statutes, but many of these specifically exclude mortgage transactions. Mortgage disclosure requirements were also contained in some provincial mortgage broker acts. All provinces except British Columbia and Quebec have similarly worded "Unconscionable Transaction Relief" acts relating specifically to credit transactions, including mortgages, under which a borrower can charge that "in regard to the risk and to all the circumstances, the cost of the loan is excessive and that the transaction is harsh and unconscionable".

All credit unions and caisses populaires are provincially incorporated. Consequently, the industry is almost exclusively regulated at the provincial level. In an attempt to bring some uniformity in consumer protection across Canada, and to simplify and reduce compliance costs, ministers of consumer affairs, met in September 1996, and agreed to a set of harmonization proposals that are intended to result in common legislative provisions and phraseology relating to consumer protection.

The proposals drew from analysis by The Uniform Law Conference and the Alberta Law Reform Institute (ALRI) and were developed and refined through consultations by the Federal/Provincial Cost of Credit Disclosure Working Group with industry and consumer representatives.

A Drafting Template, released on June 1, 1998 provided proposed wording for the provisions. Individual jurisdictions will have the discretion to decide how they will enforce the harmonized provisions.

As discussed earlier, the disclosure proposals are reflected in the legislation and regulations for the federally chartered financial institutions (chart 10). Thus, harmonization on the part of provinces would mean provisions in line with these.

Alberta was the first province off the ground in 1998 in introducing a comprehensive consumer protection statute since the harmonization agreement. Ontario was the second province to act, introducing amendments to its Consumer Protection Act as part of its Red Tape Reduction Act which was passed in 1999.

Since then, other provinces have moved ahead with initiatives to amend existing statutes or introduce new acts. Based on announced plans, by the end of 2003, all provinces and territories should have new provisions in place.

14. CANADIAN ENFORCEMENT AND COMPLAINT RESOLUTION MECHANISMS

Enforcement and self regulation in lending practices will be explored more fully following stage 2 of this project, i.e. the survey and discussion stage. The main actors in this process at present are the newly established Financial Consumer Agency of Canada and the Ombudservices services, which have recently been linked in the Financial Services Ombudsnetwork. These are described briefly below.

14.1 THE FINANCIAL CONSUMER AGENCY OF CANADA (FCAC)

The Financial Consumer Agency of Canada (FCAC) was established in 2001, as a result of the recent Bank Act changes. FCAC enforces the consumer-oriented provisions of the federal financial institution statutes and monitors the industry's self-regulatory initiatives (see ombudservice below). The agency consolidates previous enforcement mechanisms which were different for each act.

FCAC's mandate also includes promoting consumer awareness and responding to general consumer enquiries.

14.2 OMBUDSERVICES

As indicated, the financial institution acts require that institutions establish a complaint handling mechanism. Over and above this, federal financial institutions must belong to an ombudsman or an external dispute resolution body to review complaints which could not be dealt with through the institutions' internal complaint mechanisms. The chief of these services has been the Canadian Banking Ombudsman (CBO), established in 1996.

The newly established *Financial Services Ombudsnetwork* is designed to provide a focal point for ombudservices in the financial sector. The individual industry ombudsman services will form the basic elements of the network.

15. COMPARISONS BETWEEN CANADIAN AND U.S. LEGISLATION

A detailed listing of the differences between the U.S. federal legislation and Canadian federal legislation is shown in chart 11. The main differences are summarized below.

15.1 No Special Provisions for High Cost Loans

There is no equivalent to the Home Owners Equity Protection Act (HOEPA) in Canada. As discussed in section 6, HOEPA is designed to provide special protection to existing homeowners in the *subprime* market. The prohibitions in HOEPA, e.g., against negative amortization, flipping, balloon payments etc. (see chart 11) have no counterpart in the Canadian legislation.

15.2 No Public Disclosure Requirements

Canada does not have an equivalent to the Home Mortgage Disclosure Act (HMDA) requiring lending institutions to report detailed characteristics of their lending activity and borrower characteristics for regulator and public scrutiny. As discussed in section 6 this legislation was designed primarily to identify whether institutions were practicing redlining, and to identify possible discriminatory housing practices.

15.3 No Prohibition of Kickbacks, Unearned Fees, Referral Fees

RESPA contains prohibitions against referral fees, kickbacks and unearned fees. As discussed earlier in this document, this provision has generated a wave of class action suits and heated debate on the legality of yield spread premiums. There are no equivalent provisions in the Canadian legislation.

15.4 No Requirement to Distribute Information Booklets

RESPA requires that home buying borrowers be given a special information booklet, which has been prepared by HUD. TILA requires the provision of a special booklet for those taking out variable rate mortgages. There is no equivalent requirement in Canada.

15.5 No Requirement for Private Mortgage Insurance Cancellation

There is no equivalent to the Homeowners Protection Act (HPA), which requires notification when private mortgage insurance is no longer required, and automatic cancellation at a trigger point. The legislation specifically excludes public mortgage insurance (i.e. FHA insurance). However, as noted in 6.5.2, FHA insurance provides for automatic termination, and refunds of unused upfront premiums.

CHART 11. U.S. LEGISLATION WITH NO CANADIAN EQUIVALENT

GENERAL	ACT
Public Disclosure of Lending Activities and Characteristics	HMDA
Ratings of institutions on how well they meet community credit needs	CRA
Requirement to distribute special booklet for variable rate loans	TILA
Special Provisions for Sub-Prime Loans	HOEPA
Requirement to distribute a special booklet for purchase transactions	RESPA
Standard form showing charges	RESPA(HUD-1)
Disclosure of business relationships between service providers	RESPA
Prohibition of kickbacks, unearned fees	RESPA
Prohibition of referral fees	RESPA
Provision of Mortgage Servicing Disclosure Statement	RESPA
Servicing Transfer Statement	RESPA
Limits on Escrow Accounts	RESPA
Cancellation rules/disclosure on Private Mortgage Insurance	HPA
HIGH COST (HOEPA) LOANS ONLY	
Prohibition of balloon payments in first five years	HOEPA
Restrictions on flipping in first year	HOEPA
Requirement to determine borrower has ability to pay	HOEPA
No prepayment penalties after 5 years	HOEPA
No prepayment penalty any time unless paid out by unaffiliated lender	HOEPA
Negative amortization	HOEPA
Advance Payments	HOEPA
Lender not allowed to pay home improvement contractor	HOEPA
Required Statement that may lose home	HOEPA
Written notice that have 3 days to change mind	HOEPA
	HOEPA
CANADIAN PROVISIONS NOT IN U.S. FEDERAL LEGISLATION	
All mortgages open after 5 years, with maximum 3 month penalty	

COMPARISON OF FEDERAL DISCLOSURE REQUIREMENTS OF CANADA AND THE UNITED STATES
(excluding U.S. HOEPA provisions for high cost loans)

CANADA	UNITED STATES
SPECIAL BOOKLETS (at time of application)	
N.A.	All purchase transactions: lender must provide a special HUD booklet containing information on the nature of all settlement costs. VRM transactions (*includes Canadian style roll-over mortgage*). Since a standard Canadian rollover mortgage would be considered an *adjustable rate mortgage* in the U.S., issuing one would require the provision by the lender of the government booklet "Consumer Handbook on Adjustable Rate Mortgages" or a similar one. If the borrowers don't get these documents at the time of application, the lender must mail them within three business days of receiving the loan application.
CONTROLLED BUSINESS ARRANGEMENTS DISCLOSURE (at time of referral)	
N.A.	Must disclose where referral is made to a provider with whom an ownership or other beneficial interest exists. Disclosure must be made at time of referral.
MORTGAGE SERVICING DISCLOSURE STATEMENT (at time of application)	
N.A.	Discloses whether lender intends to service the loan or transfer it to another lender. Also provides information on complaint resolution.
DISCLOSURE – GENERAL	
Format: Disclosure statement must be provided with prescribed disclosures (see below). It may be a separate document or may be part of a credit agreement or application. **When:** two clear business days before the entering into the credit agreement. But with borrower consent, the initial disclosure can be provided at	**Format:** 1. A prescribed form, the *HUD-1 Settlement Statement* must be provided. This shows the actual *settlement costs* of the loan transaction (RESPA). 2. Disclosures dictated by Truth in Lending Act must be "grouped together, segregated from anything else, and not contain anything not directly related to the disclosures required under the act" **When**: Borrower can *request* to see HUD-1 Statement *(based on best estimate)* one day before settlement. HUD-1 Settlement Statement (actual costs) to be provided at settlement (if

the time required for non mortgage loans, i.e. at the time of entering into the credit agreement.	not the practice for both to attend, should be mailed as soon as possible afterwards). Good faith estimates for disclosures under TILA are required before consummation or must be placed in the mail not more than 3 business days after creditor received consumer's written application, whichever is earlier
Date deemed to be provided: A disclosure statement is deemed to be provided to the borrower (*a*) on the day recorded as the time of sending by the institution's server, if provided by electronic means; (*b*) on the day recorded as the time of sending by a fax machine, if provided by fax and the borrower has consented to receive if by fax; and (*c*) five days after the postmark date, if provided by mail; (*d*) when it is received, in any other case.	**Date deemed to be provided:** no comparable provision
Plain language: The disclosure statement must be in plain language that is clear and concise. It must be presented in a manner that is logical and likely to bring to the borrower's attention the information required to be disclosed.	**Plain language:** Terms "finance charge" and "annual percentage rate" together with the corresponding amount/rate shall be more conspicuous than any other disclosure, except creditor's identity. Since the HUD-1 Settlement Statement is a prescribed form, there is no equivalent plain language requirement for settlement costs.
Electronic Disclosure: If the borrower consents, in writing, the disclosure statement may be provided by electronic means in an electronic form that the borrower can retrieve and retain.	**Electronic Disclosure:** No comparable provision
DISCLOSURE – CONTENT	
(*a*) the principal amount of the loan; (*b*) the amount of the advance, or any advances, of the principal and when it is, or they are, to be made; (*c*) the total amount of all payments;	Amount financed (itemization required) Amount of any proceeds distributed directly to the consumer or credited to the consumer's account Total of payments and descriptive explanation

(*d*) the cost of borrowing over the term of the loan, expressed as an amount;	Finance charge and a brief description of the term
(*e*) the term of the loan, and the period of amortization if different from the term;	The number, amounts and timing of payments scheduled to repay the obligation.
(*f*) the annual interest rate and the circumstances under which it is compounded, if any; (*g*) the Annual Percentage Rate, when it differs from the annual interest rate;	Annual Percentage Rate, using that term, and a brief description such as "cost of your credit as a yearly rate".
(*h*) the date on and after which interest is charged and information concerning any period during which interest does not accrue;	The number, amounts and timing of payments scheduled to repay the obligation.
(*i*) the amount of each payment and when it is due;	
(*j*) the fact that each payment made on a loan must be applied first to the accumulated cost of borrowing and then to the outstanding principal;	No comparable disclosure
Optional Services	**Optional Services**
(*k*) information about any optional service in relation to the credit agreement that the borrower accepts, the charges for each optional service and the conditions under which the borrower may cancel the service if that information is not disclosed in a separate statement before the optional service is provided;	No specific reference
Penalties for Early Repayment	**Penalties for Early Repayment**
Whether the borrower has the right to repay before maturity, related terms and conditions , including a description of any components that comprise a formula to calculate a rebate, charge or penalty in the event that the borrower exercises the right to repay the amount borrowed before the maturity of the	A statement indicating whether or not a penalty may be imposed if the obligation is paid in full.

Default Charges Any default charges on late payment must be disclosed (however, it should be noted that the Interest Act prohibits any penalty on late charges- except interest on the amounts unpaid) **Other Charges** (a) the property, if any, over which the institution takes a security interest under the credit agreement; (b) any charge for a broker, if the broker's fees are included in the amount borrowed and are paid directly by the institution to the broker; (c) the existence of a fee to discharge a security interest and the amount of the fee on the day that the statement was provided; and (d) the nature and amount of any other charge, other than interest charges;	**Default Charges** Any dollar or percentage charge that may be imposed before maturity due to a late payment **Other Charges** Specified on HUD-1 Settlement Statement Total Sales/Brokers Commission based on price (% and amount) Detailed title charges identified on HUD-1 Settlement Statement. All possible charges are detailed on HUD 1 Settlement Statement.
Transferability of Mortgage No specific reference No specific reference No specific reference	**Transferability of Mortgage** Whether or not a subsequent purchaser of the dwelling may be permitted to assume the remaining obligation under its original terms. The fact that the creditor will acquire a security interest in the property as a result of the transaction If the borrower is required to maintain a deposit as a condition of the mortgage, the fact that the annual percentage rate does not reflect the effect of the required deposit

Disclosure after Missing Payment If the missing of a scheduled instalment payment or the imposition of a default charge for a missed scheduled instalment payment increases the outstanding balance with the result that each subsequently scheduled installment payment does not cover the interest accrued during the period for which it was scheduled, the institution must, at most 30 days after the missed payment or the imposition of the default charge, provide the borrower with a subsequent disclosure statement that describes the situation and its consequences.	**Disclosure After Missing Payment** No comparable provision
VARIABLE INTEREST RATE LOANS	
Special information booklet No requirement	**Special information booklet** Lender must provide government booklet "Consumer Handbook on Adjustable Rate Mortgages.
Description of the Variable Rate Loan and its Terms An institution that enters into a credit agreement for a loan with a variable interest rate must provide an initial disclosure statement that includes the following additional information: (*a*) the annual rate of interest that applies on the date of disclosure; (*b*) the method for determining the annual interest rate and when that determination is made;	**Description of the Variable Rate Loan and its Terms** Index or formula used in making adjustments, and information about the source. Explanation as to how interest rate and payment will be determined, including an explanation of how the index is adjusted, such as by addition of a margin. Frequency of interest rate and payment changes
Historical Example No requirement	**Historical Example** A historical example, based on a $10,000 loan amount, illustrating how payments and loan balance would have been affected based on the last 15 years of the index value, *or* Maximum interest and payment for a $10,000 loan originated at initial interest rate assuming maximum periodic increase in rates and payments.

Payment based on initial interest rate the amount of each payment based on the annual interest rate that applies on the date of the disclosure and the dates when those payments are due;	**Payment based on initial interest rate** An explanation as to how the borrower could calculate what his payments would be in these examples (see above) based on the loan amount.
Negative Amortization (i) the triggering annual interest rate above which the amount paid under a scheduled instalment payment on the initial principal does not cover the interest due on the instalment payment, and ii) the fact that negative amortization is possible	**Negative Amortization** Any rules relating to……negative amortization
Subsequent Disclosures for Variable Interest Rate Loans If the rate for the loan is determined by adding or subtracting a fixed rate of interest to or from a public rate, the institution must, at least once every 12 months, provide the borrower with a subsequent disclosure statement that contains the following information: (*a*) the annual interest rate at the beginning and end of the period covered by the disclosure; (*b*) the outstanding balance at the beginning and end of the period covered by the disclosure; and (*c*) the amount of each instalment payment due under a payment schedule and the time when each payment is due, based on the annual interest rate that applies at the end of the period covered by the disclosure. 3) If the variable interest rate for the loan is determined by a method other than that referred to in subsection (2), the institution must, at most 30 days after increasing the annual rate by more than 1% above the most recently disclosed rate, provide the borrower with a subsequent disclosure statement that contains the following information: (*a*) the new annual interest rate and the date it takes effect; and (*b*) the amount of each instalment payment and the time each payment is due, for payments affected by the new annual interest rate.	**Subsequent Disclosures for Variable Interest Rate Loans** At least once a year during which an interest rate adjustment is implemented without accompanying payment change Or: at least 25, but no more than 120 days before a payment at a new level is due, the following disclosures must be delivered or placed in the mail: (1) the current and prior interest rates (2) the index values on which they are based (3) the extent to which the creditor has forgone any increase in the interest rate (4) the contractual effects of the adjustment including the payment due after the adjustment is made, and a statement of the loan balance (5) the payment (if different from that given in (4) that would be required to fully amortize the loan at the new interest rate

DISCLOSURE OF PROHIBITION ON COERCIVE TIED SELLING A institution shall disclose the prohibition on coercive tied selling … in a statement in plain language that is clear and concise, displayed and available to customers and the public at all of its branches and at all prescribed points of service in Canada.	**DISCLOSURE OF PROHIBITION ON COERCIVE TIED SELLING** No comparable prevision
ESCROW STATEMENT	
No comparable statement required	Itemizes estimated taxes, insurance premiums and other charges anticipated to be paid from the escrow account in the first twelve months of the loan. It lists the escrow payment amount and any required cushion. Usually given at settlement, but lender has 45 days from settlement to deliver it.
CHANGES IN CIRCUMSTANCES	
Mortgage Renewal The institution must, at least 21 days before the date, provide the borrower with a disclosure statement with the same requirements as that for the initiation of the loan. The disclosure statement must also specify that (*a*) no change that increases the cost of borrowing will be made to the credit agreement between the transmission of the subsequent disclosure statement and the renewal of the credit agreement; and (*b*) the borrower's rights under the credit agreement continue, and the renewal does not take effect, until the day that is the later of the date specified for its renewal and 21 days after the borrower receives the statement. (3) An institution that does not intend to renew a credit agreement for a loan secured by a mortgage or hypothec after its term ends shall, at least 21 days before the end of the term, notify the borrower of that intention.	**Mortgage Renewal** Concept of renewal of a mortgage does not appear in the legislation. The closest equivalent is a variable rate mortgage. In fact the Canadian roll-over mortgage is looked upon as a variable rate mortgage. The disclosure requirements are therefore the same as those described above for variable rate mortgages, i.e.: at least 25, but no more than 120 days before a payment at a new level is due, the following disclosures must be delivered or placed in the mail: a) the current and prior interest rates b) the index values on which they are based c) the extent to which the creditor has forgone any increase in the interest rate d) the contractual effects of the adjustment including the payment due after the adjustment is made, and a statement of the loan balance e) the payment (if different from that given in (4) that would be required to fully amortize the loan at the new interest rate

Cancellation of Optional Services A disclosure statement made in relation to a credit agreement under which optional services, including insurance services, are provided on an on-going basis must specify that (*a*) the borrower may cancel the optional service by notifying that the service is to be cancelled effective as of the day that is the earlier of one month after the day that the disclosure statement was provided to the borrower, determined in accordance with subsection 6(6), and the last day of a notice period provided for in the credit agreement; and (*b*) the institution shall, without delay, refund or credit the borrower with the proportional amount, calculated in accordance with the formula set out in subsection (2), of any charges for the service paid for by the borrower or added to the balance of the loan, but unused as of the cancellation day referred to in the notice.	**Cancellation of Optional Services** No specific reference, although under the Homeowners Protection Act, borrower must be notified when private mortgage insurance can be cancelled, i.e. at scheduled 80% of loan to original value (lender must automatically cancel private mortgage insurance when the loan balance reaches 78% of the original property value).
ADVERTISING	
No person shall authorize the publication, issue or appearance of any advertisement in Canada that indicates the rate of interest offered on an interest-bearing deposit or a debt obligation unless the advertisement discloses, in accordance with the regulations, how the amount of interest is to be calculated. An institution that advertises a loan involving a fixed amount of credit in an advertisement that makes a representation of the interest rate, or the amount of any payment or of any non-interest charge, in relation to the loan must disclose the APR and the term of the loan. The APR must be provided at least as prominently as the representation and in the same manner, whether visually or aurally, or both. If the APR or the term of the loan is not the same for all loans to which the advertisement relates, the disclosure must be based on an example of a loan that fairly depicts all those loans and is identified as a representative example of them.	If an advertisement states a rate of finance charge, it shall state the rate as an "annual percentage rate". The advertisement shall not state any other rate except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than the annual percentage rate. If <u>any</u> of the following terms is set forth in the advertisement: (i) the amount or percentage of any downpayment (ii) the number of payments or period of repayment (iii) the amount of any payment (iv) the amount of any finance charge then <u>all</u> of the following terms must be stated (an example stating all the terms may be used) a) the amount or percentage of the downpayment b) the terms of the repayment c) the annual percentage rate, and if it may be increased after cosummation, that fact

Advertising Interest free periods Where a transaction depicted in an advertisement involves a representation, express or implied, that a period of a loan is free of any interest charges, the advertisement must disclose in a manner equally as prominent as the representation, whether or not interest, due after the period, accrues during the period. (2) If interest does not accrue during the period, the advertisement must also disclose any conditions that apply to the forgiving of the accrued interest and the APR, for a period when those conditions are not met.	**Advertising Interest free periods** No specific reference

16. DIFFERENCES BETWEEN THE CANADIAN AND U.S. ENVIRONMENTS

There are significant differences between the U.S. and the Canadian financial environment in terms of institutions, financial instruments, and markets. These dictate caution in drawing parallels between what is happening in the U.S. and what might happen in Canada.

As John Pattison wrote in his study of financial regulation in Canada:

Canadians have often looked south for guidance. But in the financial field the results may be unsatisfactory, as the U.S. financial field is not composed of the same types of institutions, the numbers of banks are out of proportion to all other nations, and the regulatory structure is disproportionately thick with regulators, laws, manuals, policies and procedures. The U.S. system is more a branch of law and a study in politics than a well-designed method of regulation.[48]

Some of the differences are touched on briefly below.

16.1.1 Institutional differences

Restrictions on branch banking in the U.S. dating back to the McFadden Act in 1927 precluded the development of the large national banks with national branching networks as in Canada. In the U.S., the banking sector is made up of a large number of community banks and other small banks. This presents regulatory problems of a different nature to those in Canada. The savings and loan industry, again, an industry composed of many small lending institutions, with no parallel in Canada, has had a checkered history. Mismanagement in S&Ls and in some cases criminal activities contributed to the massive collapse of the industry, and consequent government bail out in the eighties.[49]

16.1.2 Role of Brokers.

It is estimated that 70% of U.S. mortgage transactions go through brokers. In Canada, the figure is much lower. The Canadian Institute of Mortgage Brokers and Lenders (CIMBL) estimates that 25% of mortgages in Canada are originated by a broker (up from 12-15% in 1998). While brokers are a source of assistance to individuals in sorting through the choices, and securing the best financing deal, the widespread use of brokers in the U.S. means that there is another tier of participants to monitor and regulate.

16.1.3 Market Differences

The issue of racial targeting by predatory lenders has been one of the main themes driving the lobbying in the U.S. The disproportionate incidence of black households

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[48] Financial Markets in Canada: Regulation in a Small Economy in Global Markets, by John C. Pattison

[49] Latest estimated cost of S&L bail out is $500 billion over 30 years (source: Columbia encyclopaedia 2001 edition).

among sub-prime borrowers and anecdotal evidence of unscrupulous lenders preying on black households enhanced the urgency of introducing the HOEPA predatory lending legislation. Concerns about redlining of ghetto areas created the demand for public disclosure of lenders borrowing activities through HMDA. While race is less of an issue in Canada, immigration presents a group with less experience with the Canadian market, and therefore potentially with more vulnerability to predatory lenders.

16.1.4 Differences in Mortgage Instruments

In the U.S., the dominant mortgage instrument remains the long term mortgage with the rate fixed for the life of the mortgage (typically 30 years for a purchase mortgage). In 2001, according to data from the Mortgage Bankers of America, 88% of purchase mortgages were of this kind[50]. The use of roll-over mortgages in Canada means that borrowers have increased flexibility to refinance (every five years) without penalties. The ready availability of high ratio lending with conditions prescribed by the National Housing Act may also limit the vulnerability of borrowers to predatory practices.

The other 12% of purchase mortgages in the U.S. in 2001, are adjustable rate mortgages (ARMS). Rates may vary monthly, annually or over a longer period. One common type of ARM, often called a hybrid mortgage is a 30 year term loan in which the interest rate is fixed for a number of years, most commonly 10, 7, 5 or 3 years, and then is readjusted annually for the balance of the mortgage. These are known as 10/1, 7/1 5/1 and 3/1 ARMs.

As noted in Chart 3, the Canadian rollover mortgage would be considered an adjustable rate mortgage. In fact, a common definition of an ARM used in U.S. mortgage glossaries and websites of U.S. lenders is "a mortgage in which the interest rate is adjusted periodically based on a pre selected index. Also sometimes known as the renegotiable rate mortgage, the variable mortgage or the Canadian roll over mortgage".

16.1.5 Existing Legislation

As this paper has shown, in line with the quote from John Pattison at the outset of this section, Canada is considerably less regulated than the U.S. in the field of borrower protection. All other things being equal (which they are not, as the previous 4 points have discussed) this would presumably make Canadian borrowers more vulnerable to predatory lenders. It would also restrict the choices, place a greater regulatory burden on lenders, and impact the credit allocation mechanisms and the free flow of market forces.

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[50] The percentage has fluctuated between 92% and 76% between 1998 and 2001. The Mortgage Bankers Association of America forecast that it will be 83% in 2002.

17. OPTIONS TO SUPPORT BORROWERS IN THEIR CHOICES

From an examination of the U.S. experience and the legislation and activity in borrower protection the U.S. and Canada, it is clear that there are many mechanisms to support and protect the borrower. Among these are:

1. disclosure;
2. prohibiting certain practices;
3. ensuring that the most vulnerable are protected;
4. encouraging public scrutiny of lenders actions;
5. eligibility requirements for lenders and brokers;
6. "best practices" support to lenders and brokers;
7. encouraging prime established lenders to lend to marginal borrowers;
8. borrower education;
9. self regulation and enforcement by the industry;
10. eliminating conflicting legislation;
11. community and advocacy group activism; and
12. fostering a competitive market.

17.1 Disclosure

A requirement for disclosure of facts about the cost of borrowing in a standard form enables borrowers to do comparison shopping and get the best deal. Community groups such as the National Community Reinvestment Coalition in the U.S. have however taken aim at those pushing for increased disclosure as an alternative to tighter restrictions as a way to combat predatory lending. Disclosure, they argue is of limited value if borrowers do not understand the terms and feel to intimidated the question the deal they are being offered.

Disclosure *warning* people of the potential dangers of specific products has become more common in consumer legislation, the most well known example being warnings on cigarette packages. This approach is used in HOEPA which requires that sub-prime borrowers be warned that there is a danger that they will lose their home if they do not make their payments. The Consumers Association of Canada in their brief to the F P Harmonization Cost of Credit Working Group Cost proposed that a similar warning should be required for high cost loans in Canada.

17.2 Prohibiting certain practices

Where a practice is deemed inappropriate, one option is clearly to prohibit it. There is not always agreement however as to what is or is not appropriate. Restrictions on negative amortization and balloon payments in the first 5 years as in HOEPA unquestionably restrict choice for the borrower. For a borrower who seeks a 10 year mortgage and feels there is no likelihood at all that he will wish to repay during the term,

the restrictions on prepayment penalties in the Canadian Interest Act inevitably increase the cost for him since lenders will demand more to compensate themselves.

17.3 Ensuring that the most vulnerable are protected

HOEPA was conceived in the belief that a category of borrowers, i.e. high risk ones borrowing against existing equity in their homes:

(i) are particularly vulnerable to predatory lenders.
(ii) need to be especially sure about what they are doing (they are in the subprime category because there *is* more risk that they will be unable to pay)
(iii) should not be making certain choices because of the risks they entail (hence the restrictions in HOEPA)
(iv) need to be *protected* against being persuaded to do things that are not in their interests (hence the restrictions on flipping in the first year when the transaction is not in their interest).

As indicated, a driving force for the legislation was the fact that these borrowers were more likely to be among the less educated, lower income members of society, disproportionately members of minority groups[51].

No comparable legislation to HOEPA exists in Canada. In the absence of evidence of widespread abuse such as has occurred in the U.S., there appears to be no lobbying for similar measures here.

17.4 Facilitating public scrutiny of lenders lending activity

HMDA was conceived to enable regulators and the public with data to see whether lending institutions are operating in the public interest. As indicated, this was originally to expose redlining, later, it was expanded to see whether racial and cultural minorities were being discriminated against. The latest changes are intended to help assess whether these minorities are being exploited through higher borrowing costs.. While the act does provide insights into these issues, it has been criticized widely for producing data which lends itself to more than one interpretation, therefore exposing lenders to unfair criticisms.

No comparable legislation exists in Canada. The Canadian Community Reinvestment Coalition (see 17.10) has argued for the implementation of similar provisions.

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[51] According to 1998 HMDA data, while black borrowers accounted for only 5% of mortgage refinancing overall, they represented 19% of all subprime refinancing. Low income borrowers were only 20% of conventional prime refinancers, but 41% of subprime refinancers. Borrowers without high school or college accounted for approximately only 41% of prime mortgages but 61% of subprime mortgages.

17.5 Eligibility requirements and education for brokers

Since unscrupulous or imprudent actions by brokers have been identified as a problem in the U.S., one option is to impose more stringent eligibility requirements. Many states have tightened licensing requirements for brokers including formal training requirements, and stringent criminal background checks[52].

In Canada, licensing of brokers is through provincial mortgage broker acts or their equivalent. The Canadian Institute for Mortgage Brokers and Lenders (CIMBL), in a report produced in 2001[53], pointed to a lack of harmony in provincial licensing (including educational requirements), and extensive unlicensed mortgage broker activity. CIMBL proposes mandatory broker education requirements with uniform standards across the country.

17.6 Best practices and self regulation by the industry

The Chairman-elect of the Mortgage Bankers Association of America said publicly in October 2001 that the way to eliminate predatory lending was "not through new laws that will debilitate the lending process but for responsible lenders to reach a consensus to reform the lending process".

The Mortgage Bankers Association of America has its own *Best Practices Guidelines*. These deal with general standards of conduct, operational standards, internal review, and servicing standards. They cover areas such as: compliance, training, equitable treatment, pricing, advertising, consumer education and counseling. Obviously this can have limited influence on non banks.

Expansion of the new industry supported Canadian ombudsnetwork to encompass other types of lenders, federally and provincially chartered, would provide increased protection to borrowers across the country.

17.7 Encouraging established prime lenders to be more active in the subprime market

The California Reinvestment Committee (CRC) released a study, "Stolen Wealth: Inequities in California's Subprime Mortgage Market," on November 29, 2001. The study concluded that prime lenders in the U.S. were not serving "*low-income communities, communities of color, and seniors*". Roughly three quarters of study participants did not approach a bank or thrift for their loan. They concluded that Banks, thrifts, and prime lenders "were doing a poor job of making loans to vulnerable communities due to few retail branches in low-income and minority neighborhoods, inadequate outreach efforts, a perceived history of discrimination, and inflexible loan products".

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[52] Including fingerprinting

[53] "Blueprint for Change in the Canadian Mortgage Broker Industry", Canadian Institute of Mortgage Brokers and Lenders, September 28, 2001.

U.S. government officials are encouraging prime lenders to expand their markets and cater to sub-prime borrowers. The Director of the Office of Thrift Supervision in the U.S. recently noted that "Banks and Thrifts that engage in responsible subprime lending offer "the most effective antidote" to predatory pricing.

17.8 Borrower education

Education can take the form of counseling or advisory materials. HUD has a home counseling program which provides counseling to 250,000 consumers a year[54]

Further support for borrowers is provided by the HUD document "Buying Your Home: Settlement Costs and Useful Information" which RESPA mandates must be provided by lenders and brokers to homebuyers. In Canada, CMHC has developed a manual for homebuyers, *Home Buying Step by Step*.

17.9 Eliminating conflicting legislation

Conflicting, overlapping or contradictory legislation at different levels of jurisdiction can create different sets of rules for different categories of lender, complicate compliance and make it difficult for borrowers to comparison shop. The Canadian federal-provincial harmonization initiative is designed to bring about standardization in the rules relating to cost of credit disclosure. As indicated, the process of introducing harmonized legislation is underway.

17.10 Community and advocacy group activism

As indicated in this document, community and advocacy groups have been at the forefront of the campaign against predatory lending in the U.S. Their role has included publicizing predatory practices, targeting abusive lenders, carrying out research, lobbying, and assisting in drafting legislation in many states.

In Canada, the most active groups in the field have been the Canadian Community Reinvestment Coalition (CCRC)[55] and the Consumers Association of Canada.

CCRC has produced a variety of position papers on financial institution legislation, and provided recommendations in connection with government task forces and the Bank Act Revision. CCRC argues for the introduction in Canada of legislation similar to the Community Reinvestment Act in the U.S.

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[54] For more details on homeowner counseling in the U.S., see Homeownership Education: An Examination of the U.S. Experience and its Relevance to Canada, Hirshhorn Consulting and George McCarthy, CMC Report June 2000.

[55] The Canadian Community Reinvestment Coalition, is an advocacy group with over one hundred member supporter organizations. These include for example the Canadian Labour Congress, the National Action Committee on the Status of Women, Democracy Watch, social planning councils of various cities, and groups representing low income and disable people.

In the field of Consumer Protection, CCRC has pushed for the government to facilitate the establishment of a consumer-funded and directed Financial Consumer Organization (FCO), with a requirement that financial institutions periodically include a one-page FCO membership flyer in the institutions' mailings to their customers.

Consumers Association of Canada has also paid attention to the field of borrower protection with recommendations regarding disclosure requirements and the calculation of prepayment penalties.

However, the issue of borrower protection has not received the level of attention by advocacy and consumer groups that it has in the U.S.

17.11 Fostering competition

Effective competition places downward pressure on interest rates and other settlement costs, can limit the scope for predatory lenders, and increase the choices for borrowers. Some of the mechanisms listed above will foster competition. Others, while increasing borrower protection will diminish it.

18. VIEWS OF SELECTED PLAYERS

To obtain a perspective of some of the diverse views of those with involvement in lending, mortgage brokerage, regulation and credit counseling, the preceding sections of the report were sent out to key participants along with a set of questions (for the full questionnaire, see Appendix). Forty three packages were sent out, and resulted in ten responses, i.e., a response rate of a 23 per cent.

The responses were distributed as follows:

CATEGORY OF RESPONDENT	NO. OF RESPONSES
Banking sector	1
Trust Companies	3
Credit Counseling Associations	2
Provincial governments	2
Real Estate Industry	1
Mortgage Brokers	1
TOTAL RESPONDENTS	10

In addition to the responses listed above, a number of other respondents, while declining to complete the questionnaire[56], did comment on some aspects of consumer protection in lending. The discussion below incorporates their comments.

In view of the limited response, the views expressed cannot be construed as necessarily representative of the wide range of views surrounding this issue, but only examples of some of the views out there. For confidentiality reasons, no respondents are named.

The questions, and responses are discussed below.

18.1 Level of regulatory protection/disclosure

While the majority (6 out of 10) felt that the level of protection disclosure was "about right", there were dissenting views, with two (non lender) respondents feeling it was "too little" and one that it was "too much".

One general comment was that the U.S. was a more litigious society than Canada, which has perhaps led to legislative provisions being more precisely set out in the U.S. than in Canada.

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[56] Many felt that they did not have the knowledge to confidently respond to the questions, or (particularly in the case of regulators) were reluctant to commit themselves.

While the provincial governments responding had indicated that the level was "about right", both expressed some concern about the federal regulations relating to the ability of the borrower to waive the time period for delivery of the initial disclosure statement for a mortgage loan. A similar concern was raised by one of the other respondents.

Under the drafting template which was developed in 1998 under the federal provincial harmonization initiative (see Section 13), the two day required waiting period after the lender had provided the initial disclosure statement would be waived only if the borrower obtained "independent legal advice".

The federal government chose not to include the requirement for independent legal advice in its regulations governing federal financial institutions. Instead, while the regulations call for the initial disclosure agreement to be provided two clear business days before entering into the credit agreement by the borrower, the requirement does not apply "if the borrower consents to being provided" with the initial disclosure in accordance with the requirements for non-mortgage loans. This more relaxed requirement calls only for the initial disclosure statement to be provided on or before the entering into the credit agreement.

Other concerns raised by respondents were:

- Penalty for early repayment should be clearly disclosed in plain language as part of the mortgage document
- Disclosure of key terms was not sufficiently prominent and was often buried in the large volume of documents to be dealt with at the lawyers office.

One credit counselor felt that the nature of CMHC's mortgage insurance needed to be better explained. A misunderstanding of its nature had in some cases given borrowers a false sense of security about the risks of mortgage borrowing.

Mention was also made of the 2001 survey by the Financial Consumer Agency of Canada which found that 69% of Canadians felt that individuals have the primary responsibility to find out about risks, fees and limitations about the financial products and services they are using, that 74% of Canadians have a moderate or high knowledge of how interest rates are calculated on a mortgage, and that 87% were aware of the interest rates charged by different financial institutions when they applied for a loan or mortgage.

18.2 Are there any practices that should be prohibited?

Respondents were asked whether they felt there were any practices that should be prohibited. Four respondents felt that there was a need to prohibit some lender practices. Concerns addressed were that some lenders were targeting high risk borrowers with high interest rates and additional fees, that the legislation should address not only fraudulent practices, but inappropriate ones as well, such as high fees and the paying off of low interest rate mortgages. CMHC also received criticism from one respondent who felt that

the they should be more receptive to the efforts of borrowers in difficulty that were seeking help through community resources.

18.3 Are there any prohibitions which should be removed?

Respondents were asked whether there were restrictions that should be removed.

One Trust Company respondent pointed out that the prohibition on fines on arrears created difficulties in dealing with chronic late and irregular payers. Such accounts are costly to manage, and the restrictions are an impediment to encouraging a more disciplined payment pattern. Another felt that the maximum prepayment penalty of 3 months interest after 5 years was an impediment to longer term lending.

18.4 Should there be special restrictions for home equity/refinance loans with rates well above the market (as in the U.S. under HOEPA)?

Most respondents, lender and non-lender were not in favour of implementing an act such as HOEPA in which high risk borrowers receive additional disclosures and protections.

Lenders suggested that if marginal borrowers are to be served, then lenders must be able to price according to the risk. However, two respondents suggested that similar legislation may be appropriate in Canada to curb excesses.

18.5 Should lenders be required to publicly disclose details of mortgage lending activity (e.g. applications denied by locational breakdown/ethnic group etc.?)

There was no support for the introduction of an act such as HMDA or the CRA to assess discrimination by ethnic group or the existence of "redlining".

It was felt that discrimination of this type does not occur in Canada in the lending field, that the cost would be prohibitive, and that in any case, it would not be possible or appropriate in Canada to ask for ethnic data.

Further, it was pointed out that the data accumulated under these acts in the U.S. had yet to prove discriminatory lending practices, and that the CRA is considered ineffectual since the scope of institutions covered does not include those institutions most likely to have been involved in discriminatory practices.

18.6 Should the lending industry allocate more resources to developing best practices guidelines for mortgage lending?

Half of the respondents felt that it would be beneficial to increase the emphasis on the development of "best practices". It was pointed out however that several initiatives were already in place. The limited impact of "best practices" suggestions on "bad players" was also noted.

18.7 Do you believe that mainstream lenders should increase their involvement in lending to those with less than perfect credit backgrounds/repayment capacity?

The response was split on the issue of whether mainstream lenders should get more involved in lending to those with less than perfect credit ratings. The Trust Companies felt that mainstream lenders were not set up to price and manage riskier loans and that a separate skill set was required. However, three others were in favour, with one respondent suggesting that their involvement could curb the actions of those taking advantage of consumers without the ability to deal with major lenders.

18.7 Are you satisfied with the existing complaint resolution mechanisms for mortgage borrowers?

No respondent replied in the negative on this one. Half indicated they were satisfied, the remainder didn't know. However one respondent pointed to the fact that most people were reluctant to put their complaints on paper, and thus tended not to follow up.

18.8 Do you feel that the various regulatory and legislative restriction/requirements to protect borrowers (e.g. the Financial Institutions Acts and Interest Act are adequately enforced?

Only one respondent felt that the existing rules were not being adequately enforced. Of those with no complaints, one indicated that more time was needed to assess the work of the Financial Consumer Agency of Canada and the new Ombudsnetwork.

18.9 If you are familiar with the federal/provincial harmonization initiative on cost of credit, please indicate whether you feel it will effectively eliminate contradictory federal and provincial legislation?

The provinces both repeated concerns on the federal non-inclusion of the requirement for independent legal advice for borrower waiver of the two day waiting period (see 18.1). Of the others, the three who didn't answer with "don't know" felt that the initiative will be effective.

18.10 Do you have other suggestions to protect mortgage borrowers and assist them in securing the best possible financing?

The importance of consumer education was strongly emphasized by two respondents. The ability to prepay within 5 years with the penalty clearly disclosed in the mortgage documents was also suggested.

18.11 Do you feel that a predatory lending problem exists in Canada?
Do you feel we are at risk of experiencing an increase in predatory lending?

Respondents were asked to indicate whether in Canada, predatory lending was "not a problem", "a very small problem", or "a significant problem" . No respondents were prepared to go as far as to say that it was a significant problem. One, who had earlier expressed concern that some borrowers were facing excessive fees felt that it was a "medium" problem. Others felt that it was a small or very small problem, and one felt that it was not a problem at all.

Three respondents expressed some concern that Canada was at risk of experiencing an increase in predatory mortgage lending. The logic was that developments in Canada tend to follow those in the U.S. that the sub-prime and alternative financial services industries were indeed increasing rapidly in Canada as they did in the U.S. over the last 10-15 years, and that American financial institutions were becoming more commonplace.

On the other hand, there were an equal number who felt that there was not a risk. Several arguments were presented. One was that in Canada, things were evolving differently. It was suggested that in Canada, rather than an increase in the sub-prime home equity market, we are seeing an increase in the use of payday loans, check cashing outlets, pawnbrokers and debt consolidation firms. Another argument presented was the fact that U.S. player in the Canadian subprime market had been instructed by their U.S. parents to abide by their current U.S. guidelines and thereby avoid the backlash which occurred in the U.S.

19. CONCLUSIONS

This document has looked at the U.S. experience of predatory lending in the mortgage and home equity loan market in recent years. It has reviewed the environment and legislation in Canada and the U.S. to assess whether there is a risk of similar developments here and has examined possible options to reinforce that protection.

In this section, we draw from the facts presented in this document and the views of the players in the industry to draw some conclusions on the risks and the need for responses.

There is no evidence to date that indicates predatory mortgage lending practices are a problem in Canada. Similarly, it remains to be seen whether predatory lending would flourish in Canada in the future based on the following factors.

There is an increased potential for predatory lending in Canada. Major factors are:

- **Build up of home-equity-rich, income-poor homeowners**: in the U.S., predatory lending has been found mainly in the home equity loan market. The aging of baby boomers in Canada will increase the number of home-equity rich homeowners who are income-poor as result of reaching the end of their employment years. This creates an attractive pool of potential home equity borrowers, some of whom may have difficulty in obtaining loans in the traditional market.

- **Reduced employment security**: we may continue to see a higher incidence than before of home owning households being temporarily income poor after having been steadily employed. This adds to the market for home equity loans from those with uncertain prospects who could therefore be vulnerable to predatory lenders.

- **Internet loan advertising:** junk mail and internet "pop ups" provide a cheap way of reaching those who would like to access some of their home equity but have impaired credit records. Home equity loans and mortgage loans have become one of the most common junk mail offerings.

- **The profitability of the sub-prime market:** The Canadian subprime market will be attractive for U.S. lenders seeking expansion given the maturity of this market in the U.S. This increases the risk of experiencing the problems experienced in the U.S.

- **Less powerful lobby/advocacy groups than in the U.S. to ring the alarm bell:** in the U.S. powerful lobby/advocacy groups conducted a campaign to combat predatory lending. While Canada has its advocacy groups they do not have the resources of the massive U.S. groups to draw attention to the issue and lobby for action.

There are factors which will limit the growth in predatory lending in Canada. Among these are the following:

- **Minority groups may not be as vulnerable in Canada as those in the U.S.:** predatory lenders targeted minority groups in the U.S. This was the fact that drew the ire of community groups and made predatory lending a high profile political issue. Canada does not have the high incidence of economically depressed ethnic ghettos excluded from mainstream borrowing that were the feeding ground for predatory lenders in the U.S.

- **The backlash against predatory lending in the U.S. may have a sobering influence in Canada:** the backlash in the U.S. and the legislative response may serve as a warning to subprime lenders in Canada.

- **Other alternative financial services may cut into the growth in equity based "distress" borrowing:** Among the responses to the survey was the suggestion that things were evolving differently in Canada, with those in financial distress being catered to by payday loans and debt consolidators. This may to some extent cut into the home-equity based predatory lending market.

Should future monitoring suggest that predatory lending practices are becoming a problem in Canada, there are a number of things that could be done to enhance support to borrowers, particularly in the home equity loan market.

1. **Requiring the use of standardized disclosure forms:** Compulsory standardized disclosure forms should be developed in simple language, with appropriate emphasis given to the key elements of the cost of borrowing. Separate forms could be prepared for purchase mortgages and home equity loans.

2. **Educational material preparation:** CMHC, in consultation with lenders should prepare an information pamphlet related to home equity borrowing and its risks and regulations. This will complement existing material available from CMHC and lenders relating to homeownership and mortgages. Lenders associations and provincial brokers associations should be asked to encourage members to give the pamphlet referred to above to those applying for home equity loans.

3. **Monitoring:** the provinces and federal government should jointly monitor transgressions to mortgage disclosure regulations and other related regulations, and pool their data. The harmonization of the cost of credit disclosure rules which is underway facilitates this joint monitoring. This will enable regulators to keep track of whether predatory lending problems are developing.

4. **CMHC recognition of the importance of the subprime mortgage/home equity market:** The subprime mortgage market can play an important role in providing access to funding for those with impaired credit ratings. Given the growing importance of this sector of the market, CMHC should actively welcome those

lenders involved in this sector, collect and publish data separately on it, and work with subprime lenders to the mutually advantageous end of ensuring that the market works well and responsibly.

5. **Development of distinct best practices guidelines for home equity/mortgage lending to those with imperfect credit ratings:** Given the uniqueness of the subprime market, its relative infancy in Canada and the likely entry of new players, the development of industry driven code of conduct/best practices guidelines in this sector would be helpful, timely and feasible. To be effective, such an initiative would be developed by Canadian subprime lenders rather than by mainstream lenders. By outlining clearly what is appropriate, and what is not acceptable, the industry would be doing a service to the borrower in this important sector and helping preclude the need for future new legislative safeguards.

6. **Imposing special rules, disclosures for high cost/high risk loans**: Should predatory lending become a significant problem in the future, it may be appropriate to consider imposing special restrictions or disclosures for higher cost loans, i.e. loans more than a certain amount (taking interest rate and fees into account) above treasury bonds. These would be separate, and over and above the provisions governing mainstream loans. The nature of the disclosures/restrictions would depend on the type of problems emerging. The advantage of focusing the special measures on "high cost" loans is there would be no extra compliance costs for mainstream activity.

ACRONYMS USED

UNITED STATES.

AARP American Association of Retired Persons
ACORN Association of Community Organizations for Reform Now
AMPTA Alternative Mortgage Transaction Parity Act
CRA Community Reinvestment Act
CRC California Reinvestment Committee
FDIC Federal Deposit Insurance Corporation
FFIEC Federal Financial Institutions Examination Council
FHA Federal Housing Authority
FRS Federal Reserve System
HMDA Home Mortgage Disclosure Act
HOEPA Home Ownership and Equity Protection Act
HPA Homeowners Protection Act
HUD Department of Housing and Urban Development
NCRC National Community Reinvestment Coalition
PMI Private Mortgage Insurance.
RESPA Real Estate Settlement Procedures Act
S&L Savings and Loan
TILA Truth in Lending Act

CANADA

CBO Canadian Banking Ombudsman
CCRC Canadian Community Reinvestment Association
CMHC Canada Mortgage and Housing Corporation
FCAC Financial Consumer Agency of Canada

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Inside Mortgage Finance, Inside Mortgage Finance Publications, Inc. Bethesda MD

QUESTIONNAIRE ON CONSUMER PROTECTION IN
MORTGAGE AND HOME EQUITY BORROWING IN CANADA
(CMHC External Research Project) May 2003

Please fax completed form to me (Tony Wellman) at 613-722-6433 Or mail to me at: 236 Royal Avenue, Ottawa Ontario K2A 1T7	If you prefer me to call and discuss on a more informal basis, then please contact me. Tel: 613-722-5944 email: tonywellman@sympatico.ca
Name: Position	Company Type:
Company: Address	Phone: Fax: Email

Please use back of questionnaire or separate pages if necessary

1. In general, do you feel that the level of regulatory protection for mortgage and home equity borrowers in Canada is: too little ☐ about right ☐ too much ☐ don't know ☐ ?

Comments:

2. Is the level of disclosure appropriate? (see chart 10 on page 50)
insufficient ☐ about right ☐ excessive ☐ don't know ☐

Comments: (e.g. describe disclosures you would like to see added or removed)

3. Are there practices that should be specifically prohibited , over and above existing prohibitions? (see chart 9, page 49) yes ☐ no ☐ don't know ☐

If so, what are they, and why?

4. Are there prohibitions that should be removed? yes ☐ no ☐ don't know ☐

If so, what are they, and why?

5. Should there be special restrictions for home equity/refinance loans with rates well above the market, as in the U.S. under the Home Ownership and Equity Protection Act? (see section 6.3, page 21)

yes ☐ no ☐ don't know ☐

Comments: (please describe special restrictions if appropriate)

6. Should lenders be required to publicly disclose details of mortgage lending activities (e.g. applications denied by locational breakdown, ethnic group etc.) such as is mandatory in the U.S. under the Home Mortgage Disclosure Act? (see section 6.4, page 23). yes ☐ no ☐ don't know ☐

Comments:

7. Should the lending industry allocate more resources to developing "best practices" guidelines for mortgage lending?

yes ☐ no ☐ don't know ☐

Comments:

8. Do you believe mainstream lenders should increase their involvement in lending to those with less-than-perfect credit backgrounds/repayment capacity?

yes ☐ no ☐ don't know ☐

Comments:

9. Are you satisfied with existing complaint resolution mechanisms for mortgage borrowers?

yes ☐ no ☐ don't know ☐

If not, why?

10. Do you feel that the various regulatory and legislative restrictions/requirements to protect borrowers (e.g. the Financial Institution Acts and Interest Act (see sections 12.2 and 12.4, page 44 and 46) are adequately enforced?

yes ☐ no ☐ don't know ☐

Suggestions for improvement if appropriate:

11. If you are familiar with the federal/provincial harmonization initiative on cost of credit, please indicate whether you feel it will effectively eliminate contradictory federal and provincial regulation?

yes ☐ no ☐ don't know ☐

Suggestions for improvement if applicable:

12. Do you have other suggestions to protect mortgage borrowers or to assist them in securing the best possible financing?

Predatory Lending:

13. In the U.S., there is concern that a small minority of lenders, brokers and others involved in the loan initiation process are taking advantage of vulnerable mortgage and home equity borrowers by charging excessive fees (sometimes for unnecessary services, and products), and interest rates well in excess of what the risk dictates.

Do you feel that a similar problem exists in Canada?

- Not a problem in Canada ☐
- Very small problem in Canada ☐
- A significant problem in Canada ☐
- Don't know ☐

Comment: (If you checked the second or third boxes, then please give further details of the types of problems that you feel may exist).

14. Do you feel that we are at risk of experiencing an increase in predatory lending practices in Canada?

yes ☐ maybe ☐ no ☐ don't know ☐

Comments

15. Do you have any other comments on the issues raised or on the background document?	
You may quote me in the report, using any of my comments, if you wish Check with me first	yes ☐ no ☐ yes ☐ no ☐
You may name me in the list of those surveyed You may name my organization in the list of those surveyed	yes ☐ no ☐ yes ☐ no ☐

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